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Master's Thesis

**Asymmetries in the FTA Process of the
European Union-Turkey Customs Union
Effects & Future Aspects**

**유럽 연합 - 터키 관세 동맹 FTA 과정의 비대칭:
효과와 향후 방향**

August 2019

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Abstract

Asymmetries in the FTA Process of the European Union-Turkey Customs Union:

Effects & Future Aspects

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The Customs Union between Turkey and the European Union (EU) has made many contributions to the economies of both parties since it was established in 1996. However, there are some problems in the current Customs Union that overshadow the future economic benefits. This paper will focus on one of these Customs Union problems between the EU and Turkey: The asymmetries in the Foreign Trade Agreement (FTA) process. One of the asymmetries has resulted from the Common Commercial Policy of the EU. With the establishment of the Customs Union, Turkey has agreed to align its customs regulations same with the EU.

As a result, while exports of third parties to Turkey is enjoying the benefits of tariff-free access, Turkey is still exposed to tariffs while exporting products to the same third party. This asymmetrical situation creates unfair market conditions for Turkey. Additionally, Turkey is bound to the EU in order to start negotiations and/or establish a new trade agreement with a third country.

Consequently, Turkey is seeking for possible options to solve this problem because the EU's new trade strategy brings deep and comprehensive trade agreements with big economies that would create even bigger problems for the Turkish economy in the future.

Keywords : Turkey-European Union Customs Union, FTA asymmetries, common commercial policy, trade deficit

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List of Abbreviations

BPTF	Bilateral Preferential Trade Framework
CCP	Common Commercial Policy
CET	Common External Tariff
CETA	Comprehensive Economic and Trade Agreement
CU	Customs Union
DCFTA	Deep and Comprehensive Free Trade Area
EC	European Community
ECSC	European Coal and Steel Community
EEC	European Economic Community
EFTA	European Free Trade Association
EPA	Economic Partnership Agreement
EU	European Union
FTA	Foreign Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GSP	Generalized Scheme of Preferences
PTA	Preferential Trade Agreement
SADC	Southern African Development Community
TTIP	Transatlantic Trade and Investment Partnership
WTO	World Trade Organization

Introduction

The Customs Union between Turkey and the European Union has made many contributions to economies of both parties since it was established in 1996. However, there are some problems in the current Customs Union that overshadow the future economic benefits. This paper will focus on one of these Customs Union problems between the EU and Turkey: The asymmetries in the Foreign Trade Agreement process. Under Customs Union obligations, Turkey accepted a common commercial policy that stems from Article 16 of the Customs Union Decision 1/95. In other words, Turkey is obliged to use the same tariff schedule with the trade partners of the European Union. Consequently, CU enables third parties tariff-free access to Turkey, while Turkey is still exposed to tariffs from third parties. The EU decides its own tariffs and Turkey has to implement the tariff rates of the EU without joining in the EU tariff setting process. This asymmetrical situation creates external competition for the Turkish market.

Accordingly, Turkey started to negotiate for concluding FTAs with the countries that sign trade agreements with the EU in order to avoid trade deficit that is caused by the asymmetrical FTAs. However, third countries that have concluded an FTA with the EU sometimes are not in favor to conclude another FTA with Turkey. As a result, Turkish firms do not receive similar reciprocal access to these third country markets, while third country imports can often enter Turkey tariff-free via CU. Also, when the EU negotiates

trade agreements with third parties, there is an inadequate Turkish participation that risks future trade benefits.¹ The proliferation of the EU FTAs, especially with larger countries with the bigger economic market such as Canada or Japan, risks larger possible losses for Turkey. The EU-Turkey CU has been a very important implementation for Turkey to increase its economic welfare as well as the possibility to be a member of the EU. For this reason, the modernization of the CU is a significant issue for both sides.

The first chapter briefly looks at the bilateral trade relationship between the EU and Turkey that started in 1959 when Turkey applied for the associate membership to the EU. After 4 years, the Association Agreement was signed in 1963. The objective of the Association Agreement was to encourage continuous and stable economic and trade relations between both parties and form a customs union progressively. This treaty has included three stages: a preparatory stage that lasts 5 years, a transitional stage that involves the establishment of CU and a final stage. Customs Union has initiated a fourfold increase in the bilateral trade between the EU and Turkey. However, Turkey has faced both advantages and challenges after concluding CU with the EU. On the one hand, CU enabled Turkey to become a part of the EU's internal market for industrial goods, increased its international competitiveness and participation in the international economy. On the other hand, Turkey is facing asymmetrical problems and cannot solve it quickly because it cannot participate in the decision-making mechanism of the EU concerning

¹ See the report World Bank (2014a). "*Evaluation of the EU - TURKEY Customs Union (85830-TR)*"

external economic relations. Turkey also lacks influence in the EU's FTA negotiations with third countries.

The second chapter provides an explanation of the asymmetrical FTA problem in CU. After the establishment of CU, Turkey has adopted the common external tariff of the EU and eliminated the customs regulations of imports from third countries. Also, in order to align itself with the common commercial policy, Turkey had to conclude FTAs with third countries within five years starting from 1996 in parallel with the EU. Chapter two also provides the legal text, which is DECISION No 1/95, that causes the asymmetrical problems in CU. Due to the obligations that Turkey has to take, CU enables the third parties, which have an FTA with EU, tariff-free access to Turkey. Accordingly, third parties enjoy the benefits of tariff-free Turkish market as long as they have FTA with the EU. Turkey has to separately conclude an FTA with that third country because there is no reciprocal access for Turkey to enter third country's market without an FTA.

After the EU concludes a trade agreement with a country, Turkey also tries to start FTA negotiations for establishing an FTA in order to avoid possible trade deficit. Turkey starts negotiations just after the EU, however, the negotiation process, as well as the signature date, changes country to country. Turkey's FTAs obliges Turkey to eliminate tariffs as soon as the trade agreement comes into force while the partner country is allowed to abrogate its tariffs to Turkish products progressively. This progressive elimination of customs duties does not match with the EU's trade agreements most of the

times. Therefore, the trade liberalization is asymmetrical and this progressive elimination makes a time gap when removing tariffs on Turkish exports up to several years.² For instance, Turkey signed an FTA with Egypt, Morocco and Tunisia after the EU and elimination of tariff schedule took 13, 9 and 9 years respectively. On the other hand, Turkey was already applying the tariff schedule of the EU because of the CU regulations.

Currently, the EU has 36 trade agreements in place, 45 agreements partly in place and 8 ongoing negotiations. The EU's trade agreements consider Turkey since these countries will be able to export tariff-free products to Turkey while Turkey will still be faced to customs duties while exporting products to these countries unless there is a separate FTA. Recently, the EU has concluded a trade agreement with Canada and this agreement have potential economic risk for Turkey because of Canada's economy size. Also, some of the countries that have concluded an FTA with the EU are not willing to have a similar trade arrangement with Turkey and this also creates an economic loss for Turkey. These third countries already gain indirect preferential access to the Turkish market. Thus, that country does not open its domestic market to exports from Turkey. Countries like Mexico, South Africa, and Algeria can be given as an example. Accordingly, Turkey faces a trade deficit from these countries because it does not have an FTA with them while the EU does. Additionally, South Korea and Chile case are given as an example to illustrate how the Turkish economy is effected after Turkey is managed

² See Akman, M. S. (2010). *"The European Union's trade strategy and its reflections on Turkey: An evaluation from the perspective of free trade agreements."*

to sign an FTA with a country after the EU. Lastly, the EU's three different Customs Union with Turkey, Andorra, and San Marino will be analyzed. A comparison will be made for these three countries and their CU in order to have a better understanding of the differences.

The third chapter shows the possible actions and attempts to solve the FTA problem. The EU is currently in negotiations for deeper trade agreements with the deadlock in the Doha Round for multilateral trade negotiations and the cost of the FTA asymmetries will increase with deeper trade agreements with big markets. Both the Turkish government and the EU recognize the shortcomings of the CU, including the FTA asymmetry problem and agreed on modernizing and updating the CU. The EU started to include a "Turkey Clause" that invites its trading partner to negotiate a similar trade agreement with Turkey. However, this joint declaration is not binding for third countries so most of the times it is inefficient. In order to avoid the asymmetries in the FTA process, one of the best solutions would be to have a single and joint negotiation because FTA problems mainly arise from the fact that Turkey does not have right to participate the EU's decision-making process. Another solution would be to improve the functioning of CU while addressing its design deficiencies and extending the scope of the bilateral trade with a new FTA that covers liberalization in services and agriculture, establishment and public procurement. Last option would be to replace CU with an FTA that covers all

goods trade including industrial, agricultural and fishery products, services, non-tariff barriers, public procurement as well as the establishment.³

Lastly, the final chapter summarizes the findings and draws the conclusion of the FTA asymmetry problem in the EU-Turkey CU. It also indicates the importance of the asymmetrical problem by pointing out some of the implications of the research.

³ See the report European Commission. (2016b). *“Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement”*

CHAPTER I: Bilateral Trade of The EU-Turkey After Customs Union

1. Benefits of the EU-Turkey Customs Union

In 1959, Turkey applied for associate membership of the European Union, which was known as the European Economic Community (EEC) during that time. With this application, the process of EU membership for Turkey has started along with the relationship of Bilateral Preferential Trade Framework (BPTF) between both parties. In 1963, associate membership application resulted in an Association Agreement (the Ankara Agreement), which is seen as a legal basis of the EU-Turkey Association, between the EEC and Turkey, whereby the parties agreed to create a Customs Union.⁴ Consequently, the CU was established in 1996 through the EU–Turkey Association Council Decision 1/95. Excluding European Coal and Steel Community (ECSC) products, the CU covers industrial goods including processed agricultural commodities. The main objective of the CU is the free circulation of the goods inside the CU territory. The CU has increased competitiveness in the manufacturing sectors of Turkey. Also, the demand for Turkish exports in the EU market, as well as the foreign direct investment flows to Turkey increased considerably.

⁴ See Aytuğ, H., et al. (2017). *"Twenty Years of the EU-Turkey Customs Union: A Synthetic Control Method Analysis."*

Customs Union can be seen as the last stage of Turkey's accession to the EU. Turkey and Greece are the only countries that had or have a customs union with the EU as a final step to be a member country. After signing the agreement in 1961, Greece fulfilled its CU duty and became a member state in 1981. The CU between Turkey and the EU has been established with the same purpose in accordance with Ankara Agreement Article 28 as follows:

“Article 28 of Ankara Agreement⁵

*As soon as the operation of this Agreement has advanced far enough to justify envisaging full acceptance by Turkey of the obligations arising out of the Treaty establishing the Community, the Contracting Parties shall examine the **possibility of the accession of Turkey to the Community.**”*

During the BPTF period, the bilateral trade grew very strongly and promoted trade creation between the EU and Turkey. The EU is currently Turkey's number one trading partner and CU has a big role to achieve this. Figure 1 shows Turkey's exports to world trade and to EU member countries. It can be clearly seen that Turkey's export to

⁵ Source: Turkish Ministry of Foreign Affairs Directorate for EU Affairs
https://www.ab.gov.tr/files/ardb/evt/EEC-Turkey_association_agreements_and_protocols_and_other_basic_texts.pdf

the EU is almost half of its total exports to the world. In 2018, the EU's share in Turkish exports was 50% with approximately 84 billion USD.

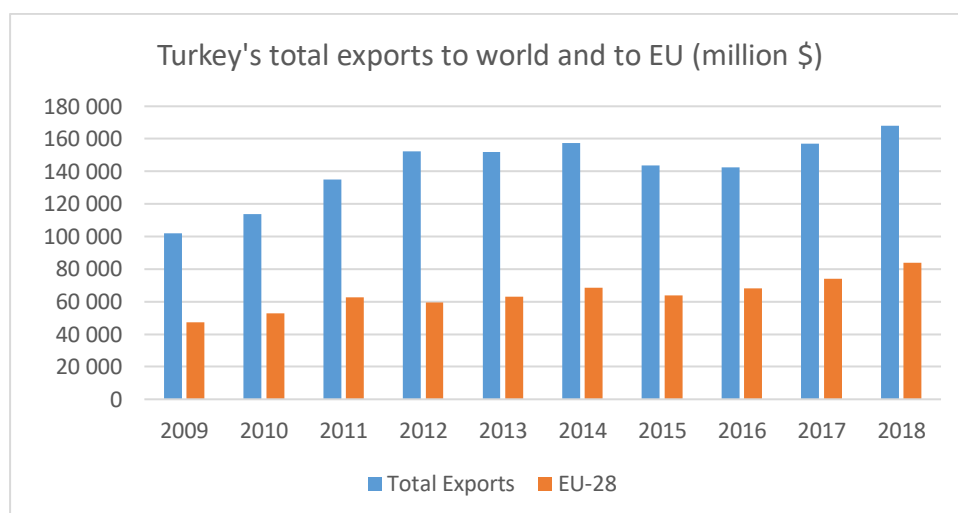


Figure 1: Turkey's total export to world and to EU (2009-2018)⁶

As Figure 2 shows clearly, the EU's share in exports and imports of Turkey have been increasing since the CU was established in 1996. When the Customs Union was first established in 1996, the total exports of Turkey were around 23 billion USD while imports were 43 billion USD and more than half of the total imports and exports of Turkey were with the EU. Countries that share a common border or geographically close have higher levels of trade volume.⁷ Geographical closeness and size of the markets had a significant impact on the international trade between parties.

⁶ Source: Turkish Statistical Institute (Annual exports by country groups): http://www.tuik.gov.tr/PreIstatistikTablo.do?istab_id=625

⁷ See Hartler, C. and S. Laird (1999). "The EU Model and Turkey—A Case for Thanksgiving?"

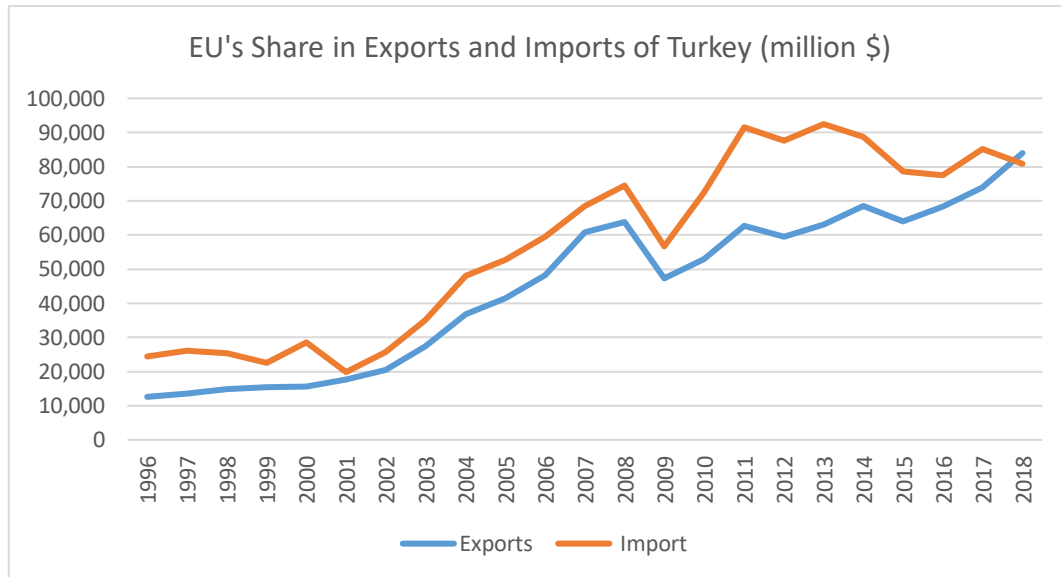


Figure 2: EU's Share in Imports and Exports of Turkey after Customs Union (1996-2018)⁸

In early 2000, the imports from the EU has decreased from 28 billion USD to 19 billion USD because of the financial crisis that caused devaluation and consequently lower rate of imports in general. In 2008, there was also a change of rapid increasing. The exports value was around 63 billion USD and it decreased to 47 billion USD. Similarly, the import value has decreased from 74 billion USD to 56 billion USD. The reason behind the decrease in 2008 can be explained with the global crisis that contracted the demand worldwide.

⁸ Source: Republic of Turkey Ministry of Trade

After 2009, both imports and exports have been increased. Also, the gap in trade balance has expanded until 2018. Turkish imports have always been higher than exports until 2018. In the previous year, the EU share of Turkish exports has ranked 83 billion 971 million USD, while the EU share of Turkish imports was 80 billion 813 million USD. Turkey gained importance as a trading partner for the EU. “For Turkey, trade with the EU surged, but the commitment to an open trading regime mandated by the BPTF resulted in trade with third parties surging even more.”⁹

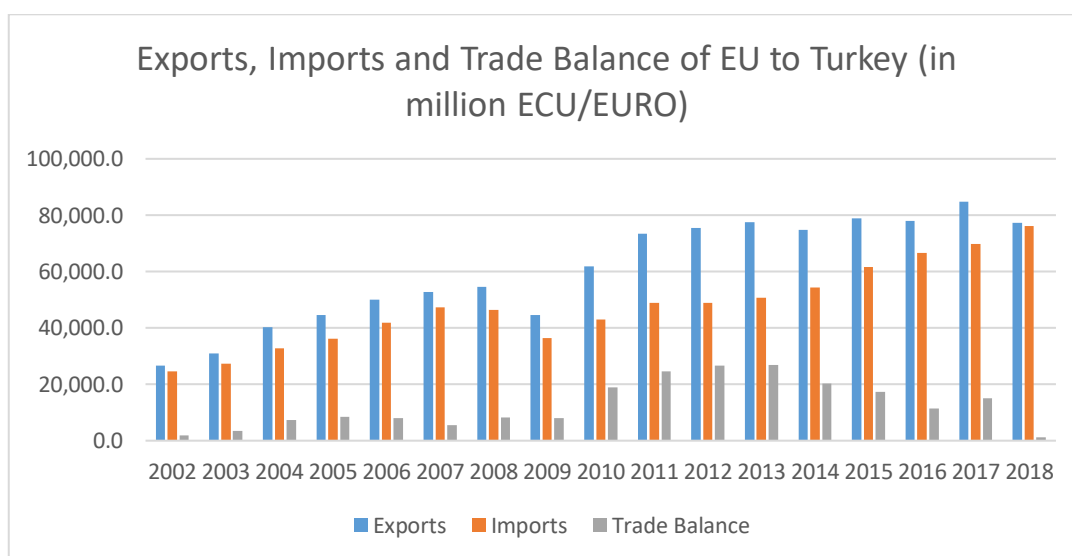


Figure 3: Exports, Imports and Trade Balance of EU to Turkey (2002-2018)¹⁰

As can be seen from Figure 3, exports of the EU to Turkey has been always higher than their imports from Turkey, which means the EU has recorded trade surplus for many

⁹ See the report European Commission (2016a). “*Impact Assessment*”

¹⁰ Source: Eurostat (Extra-EU trade by partner)

years. The highest export rate has been recorded in 2017 with 84 billion EUR while the highest import rate has been recorded in the previous year with 76 billion EUR. Also, similar to the EU's share in Turkey's imports and exports, the trade balance was recorded minimum with 1,1 million EUR in 2018. For the EU, Turkey's share of imports increased generally and ranked 3.8% while the share of exports was fluctuating and ranked 4% in the previous year.

According to the research concluded by Larch, M., et al. (2019), EU-Turkey CU has increased bilateral trade between both parties by 60%. It was also concluded that “the CU was much more successful in boosting trade than other regional trade agreements, which increased bilateral trade by 28% approximately. While the CU has contributed an increase in the EU exports to Turkey by 49%, Turkish exports to the EU have risen by 74%.”¹¹

As Togan (2015) emphasizes, “the EU–Turkey CU of 1995 has been a major instrument of integration into the EU and global markets for Turkey, offering the country powerful tools to reform its economy. It has credibly locked Turkey into a liberal foreign trade regime for industrial goods and holds the promise of Turkey's participation in the EU internal market for industrial products. As a result, Turkish producers of industrial goods have become exposed to competition from imports and they operate within one of

¹¹ See Larch, M., et al. (2019). *"A Tale of (Almost) 1001 Coefficients: Deep and Heterogeneous Effects of the EU-Turkey Customs Union."*

the largest FTAs for industrial products in the world. They are now protected by tariffs from external competition to exactly the same extent that EU producers are, and as such, face competition from duty-free imports of industrial goods from world-class pan-European firms. In return, Turkish industrial producers have duty-free market access to the European Economic Area.”¹²

2. Negative effects of the EU-Turkey Customs Union

Although the EU-Turkey CU contributed economic benefits to both Turkey and third parties, it also created some negative effects that should be reviewed in order to achieve a mutually advantageous relationship. Especially under the existing agreement, the new trade agreements of the EU create negative effects on Turkish welfare. It was widely agreed that the current CU has become outdated and should be modernized. The negative effects and/or shortcomings of the CU can be specified as the limited scope and the influence of the CU, lack of decision-making capacity of Turkey, regulatory challenges, visa barriers and transport problems, and lastly external asymmetry in the FTAs which will be covered in this paper.

¹² See Togan, S. (2015). *“The EU-Turkey customs union: a model for future Euro-Med integration.”*

CU excludes important areas such as services, public procurement and right of establishment. The scope of new generation FTAs of the EU is more comprehensive compared to the EU-Turkey CU that covers only industrial and processed agricultural products. As the EU's FTAs increase, it creates a potential power weakness for Turkey. Also, CU does not eliminate all technical barriers to trade because Turkey stays outside of the EU's single market. Therefore, it creates indirect costs for Turkish exporters.

The visa requirement creates big obstacles for Turkish businessmen and it is directly connected to the development of bilateral relations between the EU and Turkey. "Since the EU is the largest market for Turkish goods, Turkish business people and economic operators at large need to travel frequently to the EU for the purposes of attending trade fairs, negotiating contracts, meeting people, attending meetings, etc. Yet, the visa-requirement imposed on Turkish nationals hampers these activities, increases the costs or even renders it impossible."¹³ In this regard, the free movement of businessmen in Turkey seems essential for a better working CU.

As Karatas, I., et al. (2016) emphasizes, both Turkey and the EU has abolished the quantitative barriers or measures having equivalent effect with the adoption of CU. "While the abolishment of these quotas is accomplished in the area of free movement of goods, the same cannot be said of the transport sector. By subjecting Turkish vehicles

¹³ See Karatas, I., et al. (2016). *"The EU-Turkey Customs Union: Towards a Revision of the Legal and Institutional Framework?"*

entering the EU market to road transport quotas and transport permits, free movement of goods is hit in its means to be effectuated. Consequently, Turkey is dubbed the only country subject to transport quota but not to a trade quota. There are also quota limits on the number of transport while giving permission.”¹⁴

Turkey is bound to align its commercial policy and technical regulations with the EU because of the CU regulations. However, Turkey does not participate in the EU’s decision-making mechanism even though if there were some cases where Turkey participated in the meetings but it has no right to vote in the decision-making process. There has been no amendment about the decision-making process ever since the establishment of the CU and this situation is leading an asymmetrical situation. Even though Turkey’s membership in the EU seems to be the best solution to this problem, it does not seem like it is going to happen in the near future.

¹⁴ See Karatas, I., et al. (2016). *"The EU-Turkey Customs Union: Towards a Revision of the Legal and Institutional Framework?"*

CHAPTER II: Literature Review

The major reason behind this FTA problem can be explained with the Common Commercial Policy (CCP) of the EU. When Turkey and the EU established the Customs Union to enhance the trade creation, they also established common arrangements to implement when the member states import products from other countries. This CCP is based on a Common External Tariff, which helps to abolish customs duties and quantitative restrictions between parties. Throughout years, CCP's main focus was on the internal market harmonization, customs duty lowering and non-tariff barriers unification for third countries.¹⁵ Therefore, it can be said that CCP has a significant effect on the EU economy both internally and externally.

The FTA Problem of the EU-Turkey Customs Union can be found in most of the articles that argue about the CU effectiveness. Hartler, C. and S. Laird (1999) points out that, "eliminating the customs duties on imports of non-agricultural products originating in the EU and adopting of the EU's CET for imports of these products from third countries has led to a substantial reduction of its average tariffs on all imports, called as a thanksgiving to third countries."¹⁶

¹⁵ See Tkachuk, A. (2016). *"Common Commercial Policy of the European Union and its significance to the world trade. Transatlantic Trade and Investment Partnership case study."*

¹⁶ See Hartler, C. and S. Laird (1999). *"The EU Model and Turkey—A Case for Thanksgiving?"*

Ülgen et al. (2004) emphasizes that this asymmetric FTA structure creates a disadvantageous position for Turkish exporters. They also point out “Turkey has also been at risk of losing potential tariff revenues since goods originating from these third countries might not have been exported to Turkey directly but re-exported from the EU so as to take advantage of the lack of import duties.” Çalışkan, Ö. (2009) emphasizes that “as a natural consequence of this CU framework, it can be said that the Turkish foreign trade policy and its integral part of foreign policy are designed mainly by EC. In this case, if EU concludes an agreement with a third country, even which is not laid down in ACD 1/95 (such as Mexico and S. Africa in the past), Turkey is in a position of automatic application of the provisions of such agreement.”

Larch, M., et al. (2019) point out in their research that “after CU came into effect, the reductions in bilateral trade frictions between Turkey and non-EU countries have increased trade flows by 28%. Also, a larger increase is found for Turkish imports from non-EU countries than for its exports to these countries, which explains the trade deflection caused by CET. The asymmetry in CU between the EU and Turkey effects shrinks and indicates that Turkish exports benefited only a little more than EU exports.” Altay, S. (2018) also mentions in his research that accepting common commercial policy not only diminished Turkey’s bargaining power, but also decreased Ankara’s trade policy interdependence.

Doğan, A., & Uzun, A. (2014) emphasize in their research that the trade agreements that the EU signs with third parties also come into effect at the same time in Turkey because of the CU obligations. Turkey tries to start FTA negotiations with these third parties in order to prevent trade deflection. However, the time period between the agreements of the EU-third party and Turkey-third party puts Turkey in a disadvantageous position. Because Turkey also removes tariff against third countries similar with the EU due to the CU regulations.

Regarding the FTA with third parties, Yılmaz, K. (2011) emphasizes on his study that “the EU negotiates and signs FTAs with third countries without any participation of Turkey and without taking Turkey’s interest into account, something that could possibly lead to unfair trade competition for Turkey. Turkey was supposed to sign FTAs of its own with these countries, but it has proven rather difficult for Turkey to obtain concessions as lucrative as the EU has.”

In order to have a better functioning EU-Turkey Customs Union, Aslı Bilgin, A. (2018) points out that Turkey should be able to participate more effectively to decision making process of the CU. She also mentions that if there are parallel negotiations between the EU, Turkey and third party, possible trade deflection can be prevented.

CHAPTER III: Legal Basis of the FTAs in the EU-Turkey Customs Union

Customs Union came into effect with DECISION No 1/95¹⁷ of the Turkey-EC Association Council along with the Article XXIV of GATT. Under the Article XXIV of GATT, Turkey has adopted the common external tariff of the EU and eliminated the customs regulations of imports from third countries. As mentioned in Article XXIV, Turkey is conditional on applying the same duties and other regulations of commerce to the trade of territories not included in the union. In other words, the CU that was established between the EU and Turkey has eliminated the rules of origin, which determines the national sources of a product, that was normally implemented in FTAs.

As mentioned in Article 4 of Decision 1/95 below, Turkey binds itself to conclude the same or similar preferential agreements and implement the Generalized Scheme of Preferences (GSP) for its relation with third countries. Seen from an EU perspective, CCP is an exclusive competence of the Union. Article 4 of Decision 1/95 states;

“Article 4 of Decision 1/95

Import or export customs duties and charges having equivalent effect shall be wholly abolished between the Community and Turkey on the date of entry into force of this Decision. The Community and

¹⁷ Source: The EU website,
http://trade.ec.europa.eu/doclib/docs/2003/december/tradoc_115267.pdf

Turkey shall refrain from introducing any new customs duties on imports or exports or any charges having equivalent effect from that date. These provisions shall also apply to customs duties of a fiscal nature.”

As stipulated in the Article 12, Turkey applied the EU’s common policy in these regulations: “common rules for imports, common rules for imports from certain third countries, common rules for imports from certain third countries, Community procedure for administering quantitative quotas, protection against dumped and subsidized imports, Community procedures in the field of the common commercial policy, establishing common rules for exports, officially supported export credits, outward processing arrangements for textiles and clothing; textile imports under common rules, textile imports under autonomous arrangements and textile imports from Taiwan.”

Turkey also had aligned itself with the common customs tariff of the EU while trading with the third countries which are not members of the community. Article 13 of Decision 1/95 states;

“Article 13 of Decision 1/95

1. Upon the date of entry into force of this Decision, Turkey shall, in relation to countries which are not members of the Community, align itself on the Common Customs Tariff.

2. Turkey shall adjust its customs tariff whenever necessary to take account of changes in the Common Customs Tariff.

3. The Customs Cooperation Committee shall determine what measures are appropriate to implement paragraphs 1 and 2.”

“Together with the Common External Tariffs, the Preferential Trade Agreements (PTA) constitute the most important part of the trade policy applied towards third countries.”¹⁸ Article 16 of Decision 1/95 sets the rules and modalities of the alignment. In order to align itself with the common commercial policy, Turkey had to conclude FTAs with third countries within five years starting from 1996. Article 16 of Decision 1/95 states;

“Article 16 of Decision 1/95

*1. With a view to harmonizing its commercial policy with that of the Community, **Turkey shall align itself progressively with the preferential customs regime of the Community within five years as from the date of entry** into force of this Decision. This alignment will concern both the autonomous regimes and preferential agreements with third countries. To this end, Turkey will take the necessary measures and **negotiate agreements on mutually advantageous basis** with the countries concerned. The Association Council shall periodically review the progress made.*

¹⁸ See Çalışkan, Ö. (2009). "An analysis on the alignment process of Turkey to the EU's FTAs under the customs union and current challenges."

*2. In each of the cases referred to in paragraph 1 the granting of these tariff preferences shall be **conditional on compliance with provisions relating to the origin of products identical to those governing the granting of such preferences by the Community.***”

Lastly, similar with the Article 16, Article 54 of Decision 1/95 also states the requirement for Turkey to progressively align itself with the EU customs regime. Article 54 states;

“Article 54

*47. In areas of direct relevance to the operations of the Customs Union, and without prejudice to the other obligations deriving from Chapters I to IV **Turkish legislation shall be harmonized as far as possible with Community legislation.***”

CU was expected to be the last step of being a member of the EU for Turkey. While establishing the EU-Turkey CU, these legal bindings were not seen as possible causes for economic loss. However, Turkey is now legally bound to the EU customs tariff for the imports from third countries and the effects are getting bigger since the EU keeps establishing deeper FTAs with third countries.

CHAPTER IV: Negative Outcomes of Asymmetrical FTA

1. Common Commercial Policy

As mentioned previously, “Turkey has adopted the EU’s common external tariff against third country imports of industrial goods and the industrial component of processed agricultural goods.”¹⁹ The FTAs of the EU with third countries do not fully cover Turkey in terms of import regulations. CU enables the third parties, which have an FTA with EU, tariff-free access to Turkey. Because of this reason, even if the subject third country does not have FTA with Turkey, they still enjoy the benefits of the Turkish market as long as they have FTA with the EU. However, there’s no reciprocal access for Turkey to enter third country’s market unless Turkey separately concludes FTA with the third country, or is included in EU-third party FTA negotiations. As it was mentioned in the study of European Commission (2016b), “Turkey cannot grant tariff preferences in WTO negotiations independently of the EU, nor can it apply lower tariffs than the common commercial tariff in its bilateral trade agreements. The EU decides its own tariffs and Turkey has to adopt the tariff rates of the EU without joining in the EU tariff setting process.”²⁰ This asymmetrical situation creates external competition for the Turkish market.

¹⁹ See Hartler, C. and S. Laird (1999). *"The EU Model and Turkey—A Case for Thanksgiving?"*

²⁰ See the report European Commission. (2016b). *"Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement"*

The FTA Asymmetry problem creates a heavy burden for Turkey. “Turkey is forced to apply reduced or no tariff rates, while the third countries do not reduce their duties for Turkish imports. Secondly, Turkey also suffers tariff revenue losses, as the goods won’t enter the European Customs Area through Turkey.”²¹ The exporters have an incentive to transfer goods via the EU as long as they have concluded an FTA with the EU but not necessarily with Turkey. As Nas, Ç. and Y. Özer (2017) state in their article, “Turkey has implemented origin controls on imports from the EU, particularly in sensitive sectors, to determine whether they originate from countries that have an FTA with the EU.”²²

Turkey has introduced a protection measure based on the rule of origins in order to import cars from Mexico. The main goal of this measure was to prevent trade deficit. As it was mentioned in the World Bank (2014b) document, “use of such measures undermine the elimination of costly origin requirements, one of the key advantages to the CU. Another measure Turkey has introduced is the application of additional customs duties for some textile products from countries that are outside of the EU and the EU’s FTA partners. In order to apply the additional customs duties, origin controls were being

²¹ See Karatas, I., et al. (2016). “*The EU-Turkey Customs Union: Towards a Revision of the Legal and Institutional Framework?*”

²² See Nas, Ç. and Y. Özer (2017). “*Turkey and EU Integration: Achievements and Obstacles*”

conducted based on the customs declarations instead of a physical check.”²³ Consequently, market access opportunities for Turkey have been lost.

Regarding the additional fiscal duty on motor vehicles originating from Mexico, European Commission (2016b) study mentions that “Turkish government officials who were interviewed for this study pointed out that this instrument is only exceptionally applied but added that Turkey might extend such measures to other products/countries in similar cases where trade diversion can possibly occur. They also stated that the measure was based on Article 58(2) of Decision No 1/95, which foresees the possibility for the parties to take measures to remedy the injury where discrepancies in the implementation of the commercial policy cause to impairment of free circulation of goods or deflection of trade.”²⁴

As Ülgen, S. and Y. Zahariadis (2004) emphasize that third countries profits from this asymmetrical situation by trading with Turkey. They point out “third parties’ agreement with the EU allowed them to export tariff-free to the Turkish market, as their goods would enter into free circulation within the Community and therefore within the EU-Turkey CU. In return, they did not have to reciprocate because under the FTA only goods originating from the EU member states would profit from the preferential

²³ See the report World Bank (2014b). “*Trading up to High Income: Turkey Country*”

²⁴ See the report European Commission. (2016b). “*Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement*”

arrangements.”²⁵ Consequently, the FTA system of the CU diminished Turkey’s bargaining power with third countries.

The asymmetries arising from the common commercial policy also affects the EU business interests in Turkey. According to World Bank (2014a), “there were 47 EU-majority own firms that export to South Africa and 39 EU-majority own firms exporting to Algeria in 2006. These numbers increased to 59 and 44 in 2009, respectively. There were also more than 30 EU-owned firms that export to Mexico and all these EU-owned firms in Turkey accounted for 7-10% of the total firms that export to these three countries. The number of domestic-majority owned firms that export to these countries were higher but they represent a smaller percentage of 2% of the total exports. The EU-majority owned firms significantly have larger values to South Africa, Algeria, and Mexico than the domestic-majority owned firms. This situation shows that it would be in the EU’s own interest to negotiate with Turkey to finalize FTAs with third countries with which the EU has FTAs.”²⁶ It was also stated in the World Bank (2014a) report “Turkish firms have not received automatic reciprocal access to some of those markets with which the EU has negotiated FTAs, leaving them at a competitive disadvantage to EU exporters, weakening Turkey’s trade negotiating position with these countries and causing trade deflection that risks the imposition of origin controls that could undermine the benefits of the CU.”

²⁵ See Ülgen, S. and Y. Zahariadis (2004). *“The future of Turkish-EU trade relations: Deepening vs widening”*

²⁶ See the report World Bank. (2014a). *“Evaluation of the EU - TURKEY Customs Union (85830-TR).”*

“Turkey had one of the lowest applied most-favored nation (MFN) tariff levels on industrial goods, averaging 4.1% among developing countries, while tariffs on the larger non-agricultural goods category ²⁷ average 5.5%. Such low MFN tariffs significantly effects the common external tariffs that are applied on these goods by all EU members. However, countries like Argentina (14.3%), Brazil (14.1%), Egypt (10.7%) and Indonesia (7.8%) have higher average applied tariffs on non-agricultural products. Turkey also has lower average bound MFN tariffs, averaging 17%, on non-agricultural products than these countries. Consequently, Mexico may impose up to 34.8% tariffs on non-agricultural products from non-FTA countries.”²⁸ Turkey, however, does not have this privilege. Even though Turkey is considered as a middle-income country, it has tariffs on non-agricultural products on a developed country level tariff rate, which is 5.5% average, because of the CU.

As Zahariadis, Y. (2004) implies, “deep integration measures such as harmonization with EU technical regulations have further enhanced market access. Estimates of the gains are not as strong as those obtained through traditional integration, but it is suggested that Turkey has gained around 0.5% of Gross Domestic Product (GDP) from harmonization with EU technical regulations.”²⁹

²⁷ Including industrial products, fish and fishery products, minerals, metals and petroleum products, leather and rubber products.

²⁸ See Colares, J. F. and M. T. Durmus (2019). *"TURK-SWITCH: The Tariff-Leverage and Legal Case for Turkey's Switch from EU-Turkey Customs Union to FTAs with the European Union and Beyond."*

²⁹ See Zahariadis, Y. (2004). *"The economic implications of deep integration in the EU-Turkey customs union"*

Regarding the statistical trade effects of the CET, Larch, M., et al. (2019) suggest in their research that “after CU came into effect, the reductions in bilateral trade frictions between Turkey and non-EU countries have increased trade flows by 28%. Also, a larger increase is found for Turkish imports from non-EU countries than for its exports to these countries, which explains the trade deflection caused by CET. The asymmetry in CU between the EU and Turkey effects shrinks and indicates that Turkish exports benefited only a little more than EU exports.”³⁰

According to their regression analysis, trade costs might have heterogeneous effects on a sectoral basis as well. They used data of seven different sectors which are textile, wood, paper, chemicals, minerals, metal and machinery, and revealed that the EU-Turkey CU has different impacts across industries. The largest effect was found in wood and machinery while chemicals and minerals had the smallest effect. Except metals, the EU-Turkey CU has significantly contributed trade flows.

2. FTA with Third Countries

Turkey has agreed to engage in FTA negotiations in parallel with EU because of the CU obligations when the EU-Turkey CU came into effect. In other words, Turkey had

³⁰ See Larch, M., et al. (2019). *"A Tale of (Almost) 1001 Coefficients: Deep and Heterogeneous Effects of the EU-Turkey Customs Union."*

followed for the EU to start negotiations for concluding an FTA in order to engage FTA negotiations with third countries. “A ‘Turkey Clause’ was meant to give signal to the third parties but could not force them to negotiate with Turkey, as observed in the case with Algeria and Mexico.”³¹

FTA process of Turkey makes the trade regime complex and difficult. As Çalışkan, Ö. (2009) emphasizes, “Turkey unilaterally has adopted the EU trade policies including preferential regimes as a policy-taker, rather than one of the counterparties of policy-making process.”³² At that time the CU was established, Turkey was expected to be a full member of the EU in four to eight years if the membership obligations were fulfilled by Turkey. Therefore the decision-making process was not considered as a problem because Turkey would participate in the decision-making process and have influence on the trade negotiations of the EU once becoming a member country. However, Turkey is still not a member country of the EU and the decision making problem creates a big problem.

As mentioned in Article 16 of Decision No 1/95, Turkey agreed to align its commercial policy with the EU and conclude FTAs with third parties within five years starting from the date of entry into force, which is 1996. However, Turkey was unable to

³¹ See Erzan, R. (2018). *"Customs Union between EU and Turkey: A Success Story to be Nurtured."*

³² See Çalışkan, Ö. (2009). *"An analysis on the alignment process of Turkey to the EU's FTAs under the customs union and current challenges."*

meet the deadline because of the unwilling behavior of some third countries in the process of FTA negotiations. As a result of the CU, “third countries could export products to Turkey on a preferential basis but did not have to extend this preferential arrangement to Turkey. Furthermore, this asymmetric structure also put Turkish exporters at a disadvantageous position with regard to EU exporters in those third countries. Turkey has also been at risk of losing potential tariff revenues since goods originating from these third countries might not have been exported to Turkey directly but re-exported from the EU so as to take advantage of the lack of import duties.”³³ In other words, this asymmetrical situation creates unfair competitiveness for the Turkish market. The current CU also cannot fulfill WTO’s one of the main principles of the trading system: promoting fair competition.

Even though the EU-Turkey CU requires common regulations and trade policies, there was no proper cooperation between the EU and Turkey when it comes to carry out changes in commercial policies. As Ülgen, S. and Y. Zahariadis (2004) states, “the EU went ahead and concluded FTA agreements without actually taking into consideration the existence of a customs union arrangement with Turkey. As such, there were no prior consultations with Turkey and therefore Turkish concerns did not come into play during these negotiations. Yet because of the CU arrangement, Turkey was forced to conclude a

³³ See Ülgen, S. and Y. Zahariadis (2004). *“The future of Turkish-EU trade relations: Deepening vs widening”*

similar agreement with those countries after the EU did.”³⁴ The FTAs that have been concluded after 1996, including Mexico, South Africa and etc., can be given as an example.

According to the Computable General Equilibrium model that World Bank (2014a) used, “Turkey’s real income would increase as a result of finalizing non-compliant FTAs. Simulations were run assuming the ten economies identified in the Global Trade Analysis Project database that currently do not have an FTA for industrial goods with Turkey concluded one and so Turkey could export duty-free to these markets. The results show that from concluding FTAs, Turkey would gain the highest income from Mexico with 111 million USD, secondly from South Africa with 115 million USD and thirdly from Colombia with 41 million USD. Sectors that would experience the largest increases in exports would be textiles to Mexico; clothing to Mexico and South Africa; paper products to South Africa; petroleum and coal products to Mexico; and motor vehicles and parts to Mexico, South Africa and Colombia.”³⁵

Additionally, according to a difference-in-differences analysis conducted by Dincer, N. N., et al. (2018), there is a statistically significant effect on the trade diversion of the EU-Algeria FTA on Turkey. “There is also an announcement effect of the FTA that

³⁴ See Ülgen, S. and Y. Zahariadis (2004). “*The future of Turkish-EU trade relations: Deepening vs widening*”

³⁵ See the report World Bank. (2014a). “*Evaluation of the EU - TURKEY Customs Union (85830-TR)*”

shows a trade diversion between Turkey and Algeria in the period when the EU-Algeria FTA was announced three years before its adoption. The results also show that Turkish exports to Algeria could have been 12% higher if there had been no FTA between the EU and Algeria. Additionally, Turkish imports from Algeria could have been 17% higher if the FTA had not been adopted.”³⁶

The asymmetrical FTAs became a frustration for Turkey specially in mid-2000s. The EU has embraced a new trade strategy and focused on the wide-ranging FTAs with big economies such as South Korea, Canada and Japan . Also, Turkey was concerned about the Transatlantic Trade and Investment Partnership (TTIP) and tried to joined the talks in order to avoid the big trade deflection that would come from the US before its suspension.

“If TTIP was implemented, industrial products from the United States would have a free access to Turkish market.”³⁷ On the other hand, Turkey would not have reciprocity in the US market while Turkish goods would have to compete with the US products in the EU market. As Wasinski, M. (2015) implies, based on the assumption of a Bertelsmann-IFO study, Turkey could experience losses in the long term exceeding 5% of GDP along with other countries such as Mexico and Norway.³⁸ In another study,

³⁶ See Dincer, N. N., et al. (2018). *"Costs of a missing FTA: the case of Turkey and Algeria."*

³⁷ See Alkan, U. (2017). *"The Modernization of Turkey's Customs Union with the European Union: Reasons and Possible Outcomes."*

³⁸ See Wasinski, M. (2015). *"TTIP and Third Countries: Making It More Transatlantic."*

Felbermayr, G., et al. (2015) have provided “no indication to date of how Turkish industrial structures, especially in the medium term, would be affected by TTIP and the other EU free trade agreements currently under negotiation”.³⁹ The study also shows the possible scenarios for the implementation of TTIP to show what kind of effect it would create in Turkish economy if it was implemented. According to the GTAP CGE simulation study, “Turkey would face a welfare loss of US\$ 130 million if the EU and the US remove all tariff on bilateral trade but Turkey continues to face restrictions in the US market and maintains tariffs on the US imports”. Second scenario shows that the welfare loss for Turkey increases to US\$ 160 million if Turkey eliminates its import tariffs on the US manufactures. On the other hand, the welfare increases to US\$ 130 million with largest export rate of textile and clothing if Turkey and the EU conclude an FTA with the US.⁴⁰

Therefore, as Alkan, U. (2017) implies, “Turkey considered to negotiate its own FTA with the US. Another option would have been to allow the accession of countries like Turkey, Mexico and Canada to TTIP. However, accession to TTIP or a separate FTA with the USA would imply that Turkey has to undertake a higher level of trade integration in areas such as agriculture, services and public procurement. Alignment with the relevant

³⁹ See Felbermayr, G., et al. (2015). *Macroeconomic potentials of transatlantic free trade: A high resolution perspective for Europe and the world.*

⁴⁰ See the report World Bank. (2014a). *“Evaluation of the EU - TURKEY Customs Union (85830-TR).”*

EU acquis and horizontal rules through the modernization may facilitate Turkey's accession to TTIP or the conclusion of an FTA with the USA.”⁴¹

The EU and Canada has signed Comprehensive Economic and Trade Agreement (CETA) on 30 October 2016 and it is provisionally applied since 21 September 2017. CETA lowers the customs tariffs and other trade barriers between the EU and Canada. This agreement also effects Turkey directly due to the CU between Turkey and the EU. In other words, Canada now has the partial privilege to export tariff-free items to Turkey while Turkey does not have this opportunity without a separate FTA agreement with Canada. After CETA negotiations between the EU and Canada have started in 2009, Turkey also tried to start negotiations for an FTA. There is a mutual agreement on starting the FTA negotiations between Turkey and Canada since 2010 but there has been no progress.

Table 1: Turkey's Trade Volume and Trade Balance with Canada (2012-2018)

Years	2012	2013	2014	2015	2016	2017	2018
Trade Volume	2,012	2,297	2,058	1,600	1,792	3,213	3,253
Trade Balance	105	-417	-157	-258	-333	-1,121	-708

Table 1 shows the trade volume and trade balance between Canada and Turkey in the period of 2012-2018. After the CETA, the trade volume between Canada and

⁴¹ See Alkan, U. (2017). *"The Modernization of Turkey's Customs Union with the European Union: Reasons and Possible Outcomes."*

Turkey has increased from 1,792 billion USD in 2016 to 3,253 billion USD in 2018. According to the Ministry of Foreign Affairs in Turkey, industrial goods are the main trade item, followed by agricultural goods, between Canada and Turkey. Industrial product exports from Turkey account for 85% of overall exports to Canada while industrial product imports from Canada account for 82% of overall imports from Canada.

The EU recently concluded Economic Partnership Agreement with Japan on 1 February 2019. This agreement is considered as the biggest trade agreement ever negotiated for the EU since it provides an open trade zone for around 635 million people, which is almost a third of the world's GDP. The main aim of this agreement is to liberalize trade and investment and promote a closer economic relationship between parties. The Agreement includes the elimination of the customs duties, trade in services, rules of origin, intellectual property rights and public procurement.

Similar to the CETA, this agreement between the EU and Japan also considers Turkey since Japan will be able to export tariff-free products to Turkey while Turkey will still be faced to customs duties while exporting products to Japan. According to the EU-Turkey EPA, all tariffs on automotive products will be eliminated in a period of seven years from the entry into force, which is 2019. The FTA negotiations between Turkey and Japan still continue and both parties have discussed trade in goods, trade in services, government procurement, rules of origin, technical barriers to trade, e-commerce and etc. in the latest negotiation that was held in April 2019. One of the biggest reasons to

conclude Turkey-Japan FTA is to compensate potential trade diversion that would arise due to the EU-Turkey CU. It is expected by the Turkish ministers is that the Turkey-Japan FTA will be completed in 2019.

“Turkey revised its FTA policy and started to engage in FTAs that cover goods, agriculture and services. For instance, FTAs with South Korea and Singapore (also Japan -still under negotiation-) cover a wide range of areas including goods and services and investment.”⁴² The FTA with South Korea is considered to be the first DCFTA of Turkey. It includes a Framework Agreement that covers competition, intellectual property rights, trade and sustainable development. Under the Framework Agreement, Agreement on Trade in Services as well as Agreement on Investment have been signed on February 2015 and entered into force on August 2018. The current FTA negotiations with Japan, Mexico, Peru and Ukraine also include investment and services chapters.

2.1. FTAs of Turkey, the EU and Comparison

After the establishment of the Customs Union, there have been a great number of FTAs concluded by the EU. As mentioned in the previous topics, Turkey has to go through different kind process depending upon the regulations of the EU when signing an FTA. Firstly, Turkey has to start negotiations and/or sign an FTA with a third country in

⁴² See the report European Commission (2016a). *“Impact Assessment.”*

parallel with the EU. If the EU does not have an FTA with that country, Turkey cannot start FTA negotiations even if it has possible economic benefits for both side.

“The EU’s trade agreements have been the major driver of its economic growth. Trade agreements bring benefits to people and companies in both partner countries and the EU through globalization. The EU has been a significant user of FTAs and region-to-region negotiations. These fall into a number of categories. There are the Association Agreements with the states in southeastern Europe/western Balkans and the Euro-Med partners that have been largely motivated by a desire to promote economic development and political stability in EU’s near neighborhood. There are the Economic Partnership Agreements with the Africa Caribbean and Pacific (ACP) states that are largely motivated by development policy objectives. Finally, there have been the bilateral FTAs concluded with South Africa, Mexico, and Chile and the region-to-region negotiation underway with MERCOSUR that have been more commercially motivated. In addition to these full-fledged FTAs, there is a range of other co-operation agreements, including efforts to promote regulatory co-operation with the United States.”⁴³

The Customs Union Agreements eliminates customs duties in bilateral trade along with establishing a joint customs tariff for international importers. Similarly, Association Agreements, Stabilisation Agreements, (Deep and Comprehensive) Free

⁴³ See Woolcock, S. (2007). *“European Union policy towards free trade agreements.”*

Trade Agreements and Economic Partnership Agreements remove or reduce customs tariff in bilateral trade. And lastly, Partnership and Cooperation Agreements provide a general framework for bilateral economic relations as well as leaving customs tariffs as they are. As it can be seen from the Table 2 below, the EU has concluded trade agreements with 36 different country or regions.

Table 2: The EU Trade Agreements⁴⁴

Country (Region)	Agreement	In force
1. <i>Albania (Western Balkans)</i>	Stabilisation and Association Agreement	2009
2. <i>Algeria</i>	Association Agreement	01 September 2005
3. <i>Andorra</i>	Customs Union	01 January 1991
4. <i>Armenia</i>	Partnership and Cooperation Agreement	09 September 1999
5. <i>Bosnia and Herzegovina (Western Balkans)</i>	Stabilisation and Association Agreement	01 June 2015
6. <i>Botswana (SADC)</i>	Economic Partnership Agreement	05 February 2018
7. <i>Chile</i>	Association Agreement and Additional Protocol	01 March 2005
8. <i>Egypt</i>	Association Agreement	01 June 2004
9. <i>Eswatini (SADC)</i>	Economic Partnership Agreement	05 February 2018

⁴⁴ Source: European Commission website (<http://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/>)

10. Faroe Islands	Agreement	01 January 1997
11. Georgia	Association Agreement	01 July 2016
12. Iceland	Economic Area Agreement	1994
13. Israel	Association Agreement	01 June 2000
14. Japan	Economic Partnership Agreement	01 February 2019
15. Jordan	Association Agreement	01 May 2002
16. Kosovo (UNSCR 1244)	Stabilisation and Association Agreement	01 April 2016
17. Lebanon	Association Agreement	01 April 2006
18. Liechtenstein	Economic Area Agreement	1995
19. Lesotho (SADC)	Economic Partnership Agreement	05 February 2018
20. Mexico	Global Agreement	01 October 2000
21. Moldova	Association Agreement	01 July 2016
22. Montenegro (Western Balkans)	Stabilisation and Association Agreement	01 May 2010
23. Morocco	Association Agreement	01 March 2000
24. Mozambique (SADC)	Economic Partnership Agreement	05 February 2018
25. Namibia (SADC)	Economic Partnership Agreement	05 February 2018
26. North Macedonia (Western Balkans)	Stabilisation and Association Agreement	01 April 2004
27. Norway	Economic Area Agreement	1994
28. Palestinian Authority	Interim Association Agreement	01 July 1997
29. San Marino	Customs Union	01 April 2002

30. Serbia (Western Balkans)	Stabilisation and Association Agreement	01 September 2013
31. South Africa	Economic Partnership Agreement	05 February 2018
32. South Korea	Free Trade Agreement	01 July 2016
33. Switzerland	Agreement	01 January 1973
34. Syria	Co-operation Agreement	01 July 1977
35. Tunisia	Association Agreement	01 March 1998
36. Turkey	Customs Union	31 December 1995

The EU currently has continuous trade negotiations with Australia (Australia Agreement), China (EU-China Investment Agreement), India (FTA), Indonesia (FTA), Myanmar (Investment Protection Agreement), New Zealand (New Zealand Agreement) and Philippines (FTA). Also, trade agreements that have been signed with Azerbaijan, Chile, Mexico, Morocco and Tunisia are currently being updated as following: Update of Partnership and Cooperation Agreement with Azerbaijan, Modernized trade part of Association Agreement with Chile, Modernization of Global Agreement of Mexico, Update of Association Agreement to create a Deep and Comprehensive Free Trade Area with Morocco and Tunisia.

On the other hand, Turkey has concluded FTAs with 36 countries in total and 11 of them were repealed due to the accession of these countries to the EU. These 11

countries that were accepted to the EU are Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Turkey also had FTA with Syria that was signed in 2004 and came into force in 2007. However, Turkey-Syria FTA was suspended in 2011 due to the Syrian Civil War. Lastly, the FTA with Jordan that was signed in 2009 and came into force in 2011 was repealed in 2018 due to the infeasibility and unfair trade competition claimed by Jordan. Currently, Turkey has 19 FTAs in force as listed below.

Table 3: FTAs of Turkey⁴⁵

Country / Union	Signed	In Force
1. <i>European Free Trade Association (EFTA)</i>	10 December 1991	1 April 1992
2. <i>Albania</i>	22 December 2006	1 May 2008
3. <i>Bosnia-Herzegovina</i>	3 July 2002	1 July 2003
4. <i>Chile</i>	14 July 2009	1 March 2011
5. <i>Egypt</i>	27 December 2005	1 March 2007
6. <i>Faroe Islands</i>	16 December 2014	1 October 2017
7. <i>Georgia</i>	21 November 2007	1 November 2008
8. <i>Israel</i>	14 March 1996	1 May 1997
9. <i>Macedonia</i>	7 September 1999	1 September 2000
10. <i>Malaysia</i>	17 April 2014	1 August 2015
11. <i>Mauritius</i>	9 September 2011	1 June 2013

⁴⁵ Source: Republic of Turkey Ministry of Trade website: <https://www.trade.gov.tr/free-trade-agreements>

12. Moldova	11 September 2014	1 November 2016
13. Montenegro	26 November 2008	1 March 2010
14. Morocco	7 April 2004	1 January 2006
15. Palestine	20 July 2004	1 June 2005
16. Serbia	1 June 2009	1 September 2010
17. Singapore	14 November 2015	1 October 2017
18. South Korea	1 August 2012	1 May 2013
19. Tunisia	25 November 2004	1 July 2005

The FTAs signed with Lebanon, Kosovo, Sudan, Qatar and Venezuela are still under ratification process and Turkey has been engaging with trade negotiations actively with Japan, Ukraine, Peru, Democratic Republic of Congo, Indonesia, Colombia, Ecuador, Mexico, Thailand, Pakistan, Ghana and Djibouti.

The FTA between EFTA and Turkey was the only FTA that was signed before the CU was established between Turkey and the EU and it is considered as the first step to adopt preferential regimes of the EU. Also, Malaysia is the only country that has FTA with Turkey but not with the EU. Turkey started the FTA negotiations after the EU did but the process was faster with Turkey and negotiations resulted with an FTA.

Table 4 shows the signature and entry into force dates of the EU trade agreements as well as Turkish FTAs. Turkey starts FTA negotiations or emphasizes its interest in negotiating FTA with third parties just after the EU. However, negotiation time and entry into force date usually depend on how the negotiations go in the first place. Therefore,

there are some special cases where Turkish FTA came into force before the EU's trade agreements with the same country.

Table 4: Comparison of Signature and Entry into Force Dates of Turkish FTAs to the EU

Country / Union	EU		Turkey	
	Signed	In force	Signed	In force
1. <i>EFTA</i>	May 1992	January 1994 ⁴⁶	December 1991	April 1992
2. <i>Albania</i>	December 2006	April 2009	December 2006	May 2008
3. <i>Bosnia-Herzegovina</i>	June 2008	June 2015	July 2002	July 2003
4. <i>Chile</i>	November 2002	March 2005	July 2009	March 2011
5. <i>Egypt</i>	June 2001	June 2004	December 2005	March 2007
6. <i>Faroe Islands</i>	June 1996	January 1997	December 2014	October 2017
7. <i>Georgia</i>	June 2014	July 2016	November 2007	November 2008
8. <i>Israel</i>	November 1995	June 2000	March 1996	May 1997
9. <i>Macedonia</i>	September 2001	April 2004	September 1999	September 2000
10. <i>Malaysia</i>	Negotiations started October 2010, paused since April 2012		April 2014	August 2015
11. <i>Mauritius</i>	August 2009	Provisionally applied since May 2011	September 2011	June 2013

⁴⁶ January 1994 for Iceland and Norway, May 1995 for Liechtenstein

12. Moldova	June 2014	July 2016	September 2014	November 2016
13. Montenegro	October 2007	May 2010	November 2008	March 2010
14. Morocco	February 1996	March 2000	7 April 2004	January 2006
15. Palestine	February 1997	July 1997	July 2004	June 2005
16. Serbia	April 2008	September 2013	June 2009	September 2010
17. Singapore	October 2018	Waiting	November 2015	October 2017
18. South Korea	June 2010	December 2015	August 2012	May 2013
19. Tunisia	July 1995	March 1998	November 2004	July 2005

Turkey's main objective of FTA negotiation is to increase the trade volume between both parties. Turkey's overall export rate was recorded as 449% while overall import rate was recorded as 449,5 with its FTA partners in the period of 2000-2012. The export value was 1,8 million USD in 2000 and it increased up to 11 billion USD in 2012. The higher export rate of the countries that have FTA with Turkey compared to the overall export rate in Turkey shows that the market access availability for the FTA partners has been increased. Hence, the share of the export with FTA partners in the overall export rate in 2000 was 7,9% and it increased to 9,1% in 2012.

During the same period of 2000-2012, an overall increase of import rate in Turkey was recorded as 334%, while the increase in imports with FTA partners was recorded as 360%. The overall import value was 1,7 million USD in 2000 and it increased to 4,9 billion USD in 2012. The import value with FTA partners was 4,1% of overall import value in the Turkish economy in 2000 and this rate increased up to 4,3% in 2012. As it can be seen from the rates and values, Turkey had faced a trade surplus with 11,2 billion USD export value and 4,9 billion USD import value in 2012.

2.2. Asymmetrical Legal Background of FTAs (Egypt, Morocco, Tunisia Case)

Even though the overall effect of the FTAs has contributed many economic benefits to Turkey, plenty of Turkey's current FTAs are subject to the asymmetrical situation at the expense of Turkey. "Accordingly, Turkey's FTAs usually enforces Turkey to abolish tariffs and similar measures as soon as the agreement enters into force while allowing the partner country to dismantle its barriers to Turkish products progressively. Thus, the liberalization is asymmetrical and induces a time gap in the removal of tariffs on Turkish exports up to several years for some product categories following the entry into force of the Agreement."⁴⁷ Table 5 shows the time gaps in eliminating tariff schedules of Turkish FTAs with Egypt, Morocco, and Tunisia.

⁴⁷ See Akman, M. S. (2010). *"The European Union's trade strategy and its reflections on Turkey: An evaluation from the perspective of free trade agreements."*

Table 5: Time gap between entry into force and elimination of duties (Turkey - Egypt, Morocco, Tunisia)

	Signature	Entry into force	Schedule for elimination of the customs duties	Time gap
Egypt	2005	2007	2020	13
Morocco	2004	2006	2015	9
Tunisia	2004	2005	2014	9

For example, Turkey-Morocco FTA has been signed on 7 April 2004 and came into effect on 1 January 2006. Morocco also has an Association Agreement with the EU that came in force in March 2000. In Article 40 of Turkey-Morocco FTA below, customs duties and charges having an equivalent effect on imports applicable in Turkey to products originating in Morocco shall be abolished upon the entry into force.

“ARTICLE 40 of Morocco-Turkey FTA⁴⁸

Entry into force

*This Agreement shall enter into force **on the first day of the second month**, following the date of the receipt of the latter diplomatic note, by which the Parties have notified each other through diplomatic channels, that their internal legal requirements for the entry into force of this Agreement have been fulfilled.”*

⁴⁸ Source: Republic of Turkey Ministry of Trade: <https://www.trade.gov.tr/free-trade-agreements/morocco>

On the other hand as it can be seen from Table 5, “parallel to the Association Agreement between Morocco and the EU, customs duties and charges having equivalent effect on a group of sensitive industrial products originating from Turkey will be dismantled gradually under a period of nine years”.⁴⁹

As another example, Egypt-Turkey FTA has been signed on 27 December 2005 and came into force on 1 March 2007 while the Association Agreement between Egypt and the EU came in force in June 2004. “Customs duties applied by Turkey on industrial goods originating in Egypt have been abolished by the entry into force of the Egypt-Turkey FTA. On the other hand, as it can be seen from Table 5, customs duties applied by Egypt on the industrial goods originating in Turkey will be abolished gradually until 1 January 2020 according to the lists provided in Protocol I of the Agreement in line with the Association Agreement between the EU and Egypt.”⁵⁰

Moreover, the Tunisia-Turkey FTA has been signed on 25 November 2004 and entered into force on 1 July 2005. “The customs duties and charges having equivalent effect on imports applicable in Turkey to products originating in Tunisia has been abolished upon the entry into force of this Agreement. On the other hand, regarding to the goods listed in List I, List II and List III of Protocol I of the Agreement, customs duties

⁴⁹ See Çalışkan, Ö. (2009). *"An analysis on the alignment process of Turkey to the EU's FTAs under the customs union and current challenges."*

⁵⁰ Source: Republic of Turkey Ministry of Trade <https://www.trade.gov.tr/free-trade-agreements/egypt>

applied by Tunisia for the goods originating in Turkey have been eliminated gradually until 1 July 2014 in line with the Association Agreement that was came in force on March 1998 between the EU and Tunisia.”⁵¹

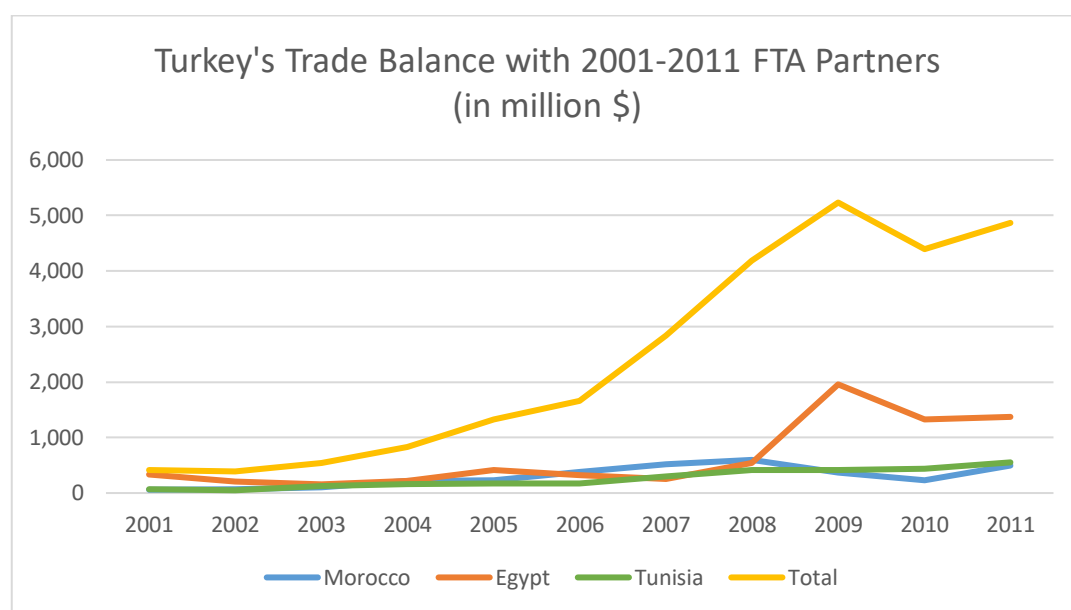


Figure 4: Turkey's Trade Balance with FTA Partners (2001-2011)⁵²

Most of Turkey's FTAs has been signed came into force in between 2001 and 2011. Figure 4 shows the comparison of the trade balance of all FTAs that came into force in 2001 and 2011 and Morocco, Egypt and Tunisia FTA. Total number of FTAs in Figure 4 includes 11 countries: Albania (entry into force in 2008), Bosnia-Herzegovina (entry

⁵¹ Source: Republic of Turkey Ministry of Trade <https://www.trade.gov.tr/free-trade-agreements/tunisia>

⁵² Source: Republic of Turkey Ministry of Trade, Foreign Trade Statistics and Economic Indicators

into force in 2003), Chile (entry into force in 2011), Egypt (entry into force in 2007), Georgia (entry into force in 2008), Montenegro (entry into force in 2010), Morocco (entry into force in 2006), Palestine (entry into force in 2005), Serbia (entry into force in 2010), Tunisia (entry into force in 2005) and lastly Syria (entry into force in 2007).

In the time period of 2001 and 2011, the trade volume has increased with the FTAs signed with different countries. As it can be observed from Figure 5, the asymmetrical regulations of CU that were found in countries like Morocco, Egypt and Tunisia create a slow-paced increase compared to the total increase in trade that comes from FTAs signed in the same period.

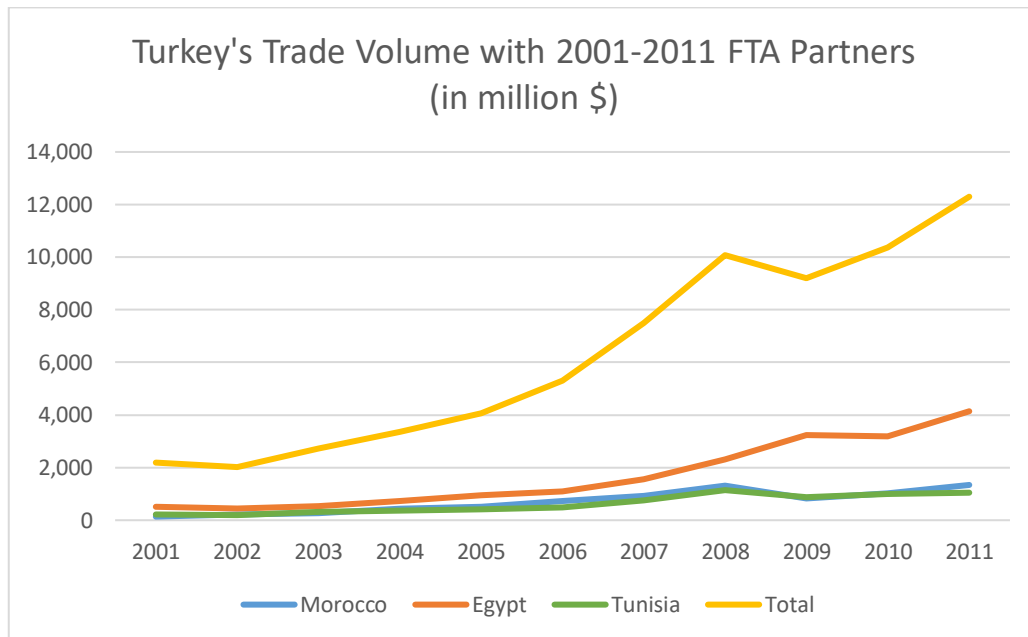


Figure 5: Turkey's Trade Volume with FTA Partners (2001-2011)⁵³

Similar to the results shown in Figure 4, Figure 5 shows the trade volume of all FTAs signed between 2001 and 2011 and FTAs signed with Morocco, Egypt and Tunisia. Trade volume with Tunisia increased from 214 million USD in 2001 to 475 million USD in 2006, a year after the FTA came into force. Trade volume with Egypt increased from 513 million USD in 2001 to 2,313 billion USD in 2008, a year after the FTA came into force. Lastly, trade volume with Morocco was lower with 136 million USD in 2001 and it increased to 1,318 billion USD in 2007. There was an overall increase in trade volume with these three countries. However, compared to the overall trade volume with all FTAs

⁵³ Source: Republic of Turkey Ministry of Trade, Foreign Trade Statistics and Economic Indicators

signed in the same period, the trade volume with Morocco, Tunisia and Egypt seem to be low. The trade volume of FTAs was recorded as 2,187 billion USD while it was recorded 12,298 billion USD in 2011.

“As it can be seen from the case countries, when the EU FTA partner concluded another FTA with Turkey, there was a substantial time span between the entry into force of the FTAs with the EU and that of the FTAs with Turkey. These difficulties temporarily created market access and competitiveness gap to detriment of Turkey since it could not benefit from preferential access to the markets of those EU FTA partners while goods of the EU trade partners have access to the Turkish market through the CU.”⁵⁴

⁵⁴ See the report European Commission. (2016a). *“Impact Assessment”*

CHAPTER V: Effects of FTAs

1. Effects of the EU's FTAs on Turkey

Some of the countries that have concluded an FTA with the EU are not willing to have similar trade arrangements with Turkey. In practice, the two motives can be argued to explain this reluctance. "First, the third country already gains preferential access into the Turkish market indirectly thanks to 'free circulation' of its exportables into Turkey via the EU. Therefore, there is no logical reason for a sovereign country to open its domestic market to Turkish exports in return. Turkey apparently cannot reciprocate by raising tariffs to products originating from these countries claiming that the latter refrained from proposing similar concessions to Turkish products under a similar FTA. This is because Turkey has already agreed to align its customs regime and its customs duties to that of the EU. Second, the third country may not be ready to surrender its uncompetitive domestic industries if Turkish counterparts are dominant in the relevant sectors, even it agrees to initiate a bilateral agreement (i.e. safeguard mechanism or sectoral exceptions)."⁵⁵ While Turkey tries to start negotiations for an FTA with the third party that has concluded an FTA with the EU, this time period puts Turkey out of countenance and creates asymmetrical market competition.

⁵⁵ See Akman, M. S. (2010). *"The European Union's trade strategy and its reflections on Turkey: An evaluation from the perspective of free trade agreements."*

1.1. Mexico Case

Mexico has concluded an FTA with the EU that came into effect in 2000 but there is no FTA between Turkey and Mexico. The FTA between the EU and Mexico enabled 97% tariff-free market between two parties until 2007. Due to the EU-Turkey CU, Mexico is able to export to Turkey without tariff and expose 10% to 20% tariffs for the imports that come from Turkey. Because of this advantageous position, Mexico does not seem to conclude another FTA with Turkey.

The trade agreement between the EU and Mexico creates an unfair competitive advantage for the EU products against Turkish products in the Mexican market and increases the competition conditions of Mexican products in the EU market unilaterally. Additionally, Mexico is able to export products to Turkey through the EU and this creates unfair competition and financial losses for Turkey.⁵⁶ Figure 6 shows the export and import values along with trade balance with Mexico. The trade balance with Mexico in 2001, 2002 and 2004 shows a trade surplus while the rest of the years show trade deficit in Turkey. The figure also shows that the trade deficit has continued to rise especially after 2005. The overall exports to Mexico have increased 5 times while the overall imports from Mexico have increased 16 times in the period between 2000 and 2012.

⁵⁶ See Şen, E., et al. (2008). *"Meksika Yerinde Pazar Arastirmasi (Market Research on the Field of Mexico)."*

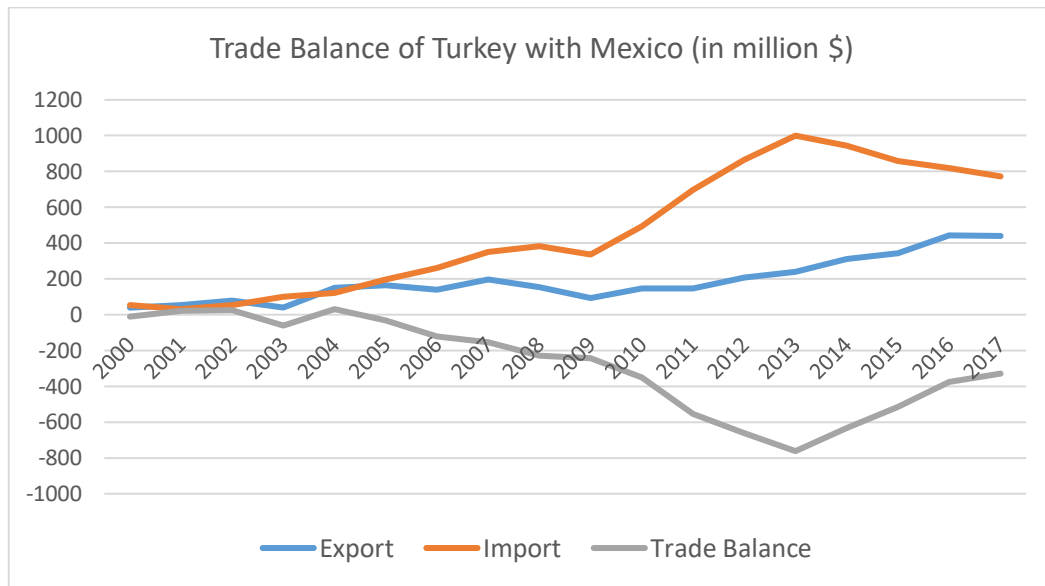


Figure 6: Trade Balance of Turkey with Mexico (2000-2017)⁵⁷

Due to the global crisis in 2008, total imports of Turkey has decreased by approximately 44% from 202 billion USD to 140 billion USD in 2009. During the same period, imports from Mexico has decreased by 13% from 382 million USD to 335 million USD. Exports of Turkey to Mexico has increased around 30% from 238 million USD to 312 million USD in 2014 compared to 2013. However, imports of Turkey from Mexico started to decrease 5,6% from 1 billion USD to 944,7 million USD in the same years. According to Turkish statistics, Turkey had a trade deficit of 637,7 million USD in 2014. On the other hand, Mexican statistics claim that exports of Turkey to Mexico had increased 21,2% to 639,1 million USD while imports of Turkey from Mexico has

⁵⁷ Source: Source: Republic of Turkey Ministry of Trade, Foreign Trade Statistics

decreased 8,5% to 327,8 million USD in the same years. According to the Mexican statistics, Turkey had a trade surplus with 311,3 million USD in 2014.

The biggest reason behind the increase in imports of Turkey from Mexico is that the Mexican products started to enter Turkey tariff free due to the FTA that came into force between the EU and Mexico. Mexican companies that have a trade relationship with Turkey use the EU countries as a road in order to enable tariff-free trade with Turkey. Because of the EU-Mexico FTA, Mexico started to change the import sources in industrial products to the EU countries. For instance, imports of the motor vehicle parts from Turkey in 2000 increased 91% from 7.000.000 USD in 2006, then decreased again around 100% to 7.000.000 USD in 2008. During this period, imports of the motor vehicle parts from the EU in 2000 increased from 1.143 million USD to 2.3 million USD in 2009. The export value of motor vehicle parts of Mexico to EU was 16,5% of total exports and it increased to 22% in 2008.

Mexico exports tariff-free motor vehicle parts to Turkey while Turkey is exposed to %15 tariff in order to export the same product to Turkey. In other words, Turkey sells the same product 15% more expensive. Additionally, Mexico was importing fiber and carpet products from Turkey but they started to import the same products from the EU

after signing an FTA agreement. Specially Turkish carpets became 30% more expensive compared to the ones from the EU.⁵⁸

In conclusion, the trade deficit of Turkey kept increasing after the EU-Mexico trade agreement which enabled Mexico to penetrate Turkish market tariff-free because of the EU-Turkey CU. The negotiations for Turkey-Mexico FTA is still ongoing since 2014. It is expected that Turkey-Mexico FTA will not only eliminate tariffs on goods and services but also result in a greater flow of capital investment between the two countries.

1.2. South Africa Case

The foundation of the trade relations of South Africa and the EU was the Trade, Development and Cooperation Agreement that was concluded in 1999. This agreement established a free trade area over a transitional period of maximum 12 years on the South African side and maximum 10 years on the EU side. The free trade area between the EU and South Africa covers free movement of goods in all sectors and it provides trade liberalization in services. Trade relations between South Africa and Turkey has started in 1966 and started to rise specially after 1981. After 2000s, Turkey's strategic approach in foreign trade relations as well as South Africa's movements in open trade has contributed an increase in the trade volume between two countries.

⁵⁸ See Özen, A. B. (2016). *"Avrupa Birliği Serbest Ticaret Anlaşmalarının Türkiye Üzerine Yansımaları (Reflections of European Union FTAs on Turkey)."*

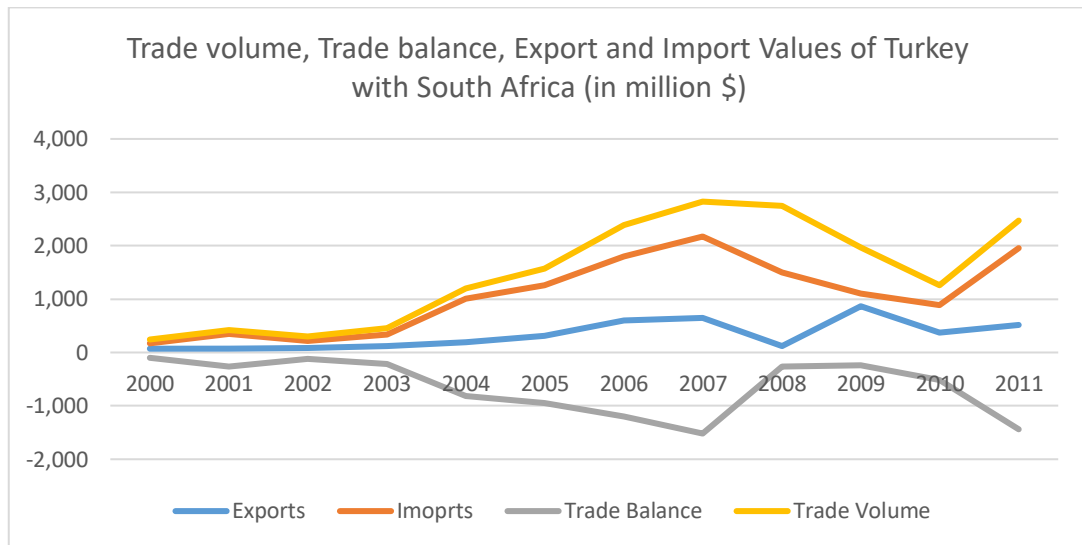


Figure 7: Trade Volume, Trade Balance, Export and Import Values of Turkey with South Africa (2000-2011)⁵⁹

Figure 7 shows export, import, trade volume and trade balance values in the period of eleven years after the signature of the EU-South Africa trade agreement. It can be observed that imports from South Africa kept increasing from 171 million USD in 2000 to 2,1 billion USD in 2007. Both trade volume and imports from South Africa have been effected by the global crisis in the following years. However, Turkey managed to scale down trade balance in between 2008-2009 by increasing its exports to South Africa approximately 600% from 123 million USD to 866 million USD. Turkey was never able to reach to that value from its exports to South Africa and trade deficit of Turkey kept increasing after 2011.

⁵⁹ Source: Turkish Statistical Institute (Annual trade balance and volume by country, import by country, export by country): http://www.tuik.gov.tr/PreIstatistikTablo.do?istab_id=625

Similar with the previous cases, Turkey faces unfair competitiveness since products from South Africa can enter Turkish market tariff-free while products from Turkey are exposed to high tariff rates in South Africa. The necessity for establishing an FTA between South Africa and Turkey has been discussed in several meetings, such as Turkey-South Africa Business Forum. However, South Africa prefers to keep the advantageous situation and avoid signing an FTA with Turkey.

Table 6: Imports and Exports of Turkey and South Africa (2010-2017)⁶⁰

	Turkey		South Africa	
	Imports	Exports	Imports	Exports
2010	1,855,443	1,138,832	968,354	913,472
2011	2,408,416	1,349,068	1,244,300	1,088,146
2012	2,365,451	1,524,617	1,271,541	996,059
2013	2,516,612	1,518,026	1,263,300	961,534
2014	2,421,770	1,576,100	1,219,500	930,433
2015	2,072,340	1,438,390	1,046,510	808,654
2016	1,986,180	1,425,300	915,923	763,147
2017	2,338,000	1,569,930	1,013,260	888,372

Table 6 shows the total export and imports values of Turkey and South Africa in million USD in the period of 2010-2017. Turkey's trade volume in world trade was 29,5 billion USD while South Africa's trade volume was 16,2 billion USD in the period of

⁶⁰ Source: WTO statistics

<http://stat.wto.org/StatisticalProgram/WSDBStatProgramHome.aspx?Language=E>

2010-2017. Additionally, Turkey's imports and exports have increased around 0,5% and 0,4% respectively while South Africa's imports have increased 0,1% but exports have decreased around 0,1% in 2017. It can be concluded from the data that Turkey's competitiveness in world trade is higher than South Africa's. Turkey's competitiveness would increase even higher if both parties agree on establishing an FTA.

2. Effects of the FTAs concluded by Turkey after the EU

Turkey tries to start FTA negotiations to conclude a separate agreement after the EU starts negotiations and/or concludes trade agreement with a third party. Even though Turkey starts the FTA negotiations just after the EU does, there is usually a time gap, that varies from two to ten years, between the trade agreements of EU and Turkey with third parties. This time period puts Turkey out of countenance and creates asymmetrical market competition most of the times. Therefore, Turkey tries to conclude the negotiations as soon as possible after the EU establishes a trade agreement with a third party. It is really important for Turkey to establish an FTA with a third party that also concluded an FTA with the EU because concluding an FTA separately usually helps Turkey to recover trade deficit.

2.1. South Korea Case

The EU-South Korea FTA, which is considered as a new generation FTA that enables more comprehensive in scope than the EU's previous bilateral trade agreements,

was signed in 2010, provisionally applied after 2011 and came into force in 2015. Turkey started negotiations with South Korea FTA in parallel with the EU and signed an FTA on August 2012. Consequently, South Korea-Turkey FTA came into effect on May 2013. In the first year of EU-Korea FTA, 94% of all EU tariff lines were liberalized equivalent to about 90% of the value of Korean exports to the EU.

On the other hand, Turkey-Korea FTA shows that the Korean liberalization is 80% equivalent to 65% of the value of EU exports to Turkey. 90% of liberalization will be ensured on tariff elimination until January 2023. Turkey-Korea FTA requires Turkey to take seven years to abolish its import tariffs on industrial products from South Korea while the EU has agreed to take five years. The asymmetries on the legal background of FTAs can also be seen in the EU-South Korea and South Korea-Turkey FTAs.

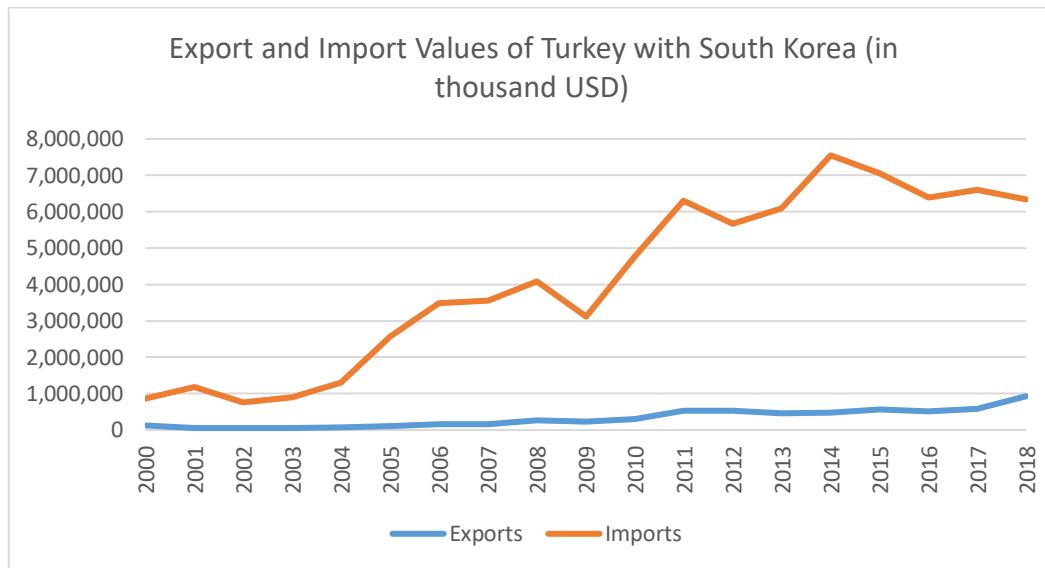


Figure 8: Export and Import Values of Turkey with South Korea (2000-2018)⁶¹

Figure 8 shows the export and import values of Turkey with South Korea in the period of 2000-2018. It can be clearly seen that the trade volume between the two countries kept increasing, yet Turkey has been facing a high value of trade deficit. Especially in the time period between 2002 and 2008, the trade deficit of Turkey has increased around 350%. Trade between South Korea and Turkey has been affected by the global crisis that caused a decrease in imports from South Korea between 2008 and 2009. After the signature of the FTA between the EU and South Korea in 2010, imports from South Korea has increased expeditiously from 4,7 billion USD to 6,2 billion USD. After the signature of Turkey-Korea FTA, Korea's export has increased around 2,3% in 2014

⁶¹ Source: Turkish Statistical Institute (Annual import and export by country): http://www.tuik.gov.tr/PreIstatistikTablo.do?istab_id=625

and 20,9% in 2015 compared to the previous year. The trade volume has increased by approximately 66% from 4,3 billion USD to 7,2 billion USD in the past ten years.

Table 7: Turkey's export volume to South Korea after FTA⁶²

Years	2013	2014	2015	2016	2017	2018
Exports	460,050	470,463	568,635	518,774	584,114	929,106

Table 7 shows the export volume of Turkey to South Korea in thousand USD after the FTA between South Korea and Turkey came into effect in 2013. The values are still very low compared to imports coming from South Korea, however, it can be seen that the FTA contributed approximately 98% increase in exports of Turkey to South Korea from 460 million USD to 929 million USD. In other words, FTA increased Turkey's competition while trading with South Korea.

In 2007, 15,28% of the total automotive imports of the EU came from South Korea, while it was 17,85% of total automotive imports to Turkey from South Korea. It shows the importance that Turkey-South Korea FTA was meant to be signed in order to maintain the competitiveness of Turkey specially in the automotive industry which has a bigger importance for Turkey compared to the EU.

⁶² Source: Turkish Statistical Institute (Annual export by country):
http://www.tuik.gov.tr/PreIstatistikTablo.do?istab_id=625

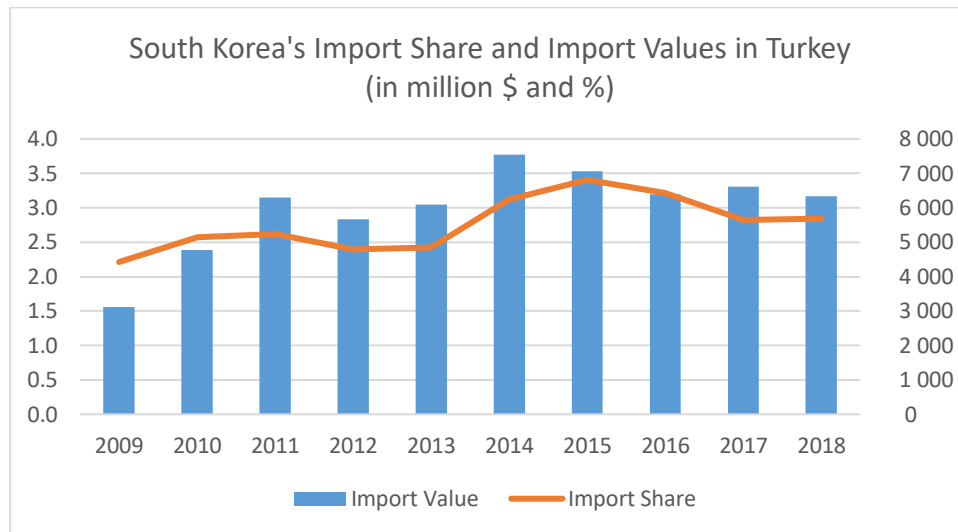


Figure 9: South Korea's Import Share and Import Values in Turkey (2009-2018)⁶³

South Korea was ranked as the 10th country that imports Turkey the most with 6,3 billion USD in 2018. Figure 9 shows that after South Korea-Turkish FTA, imports of Turkey from South Korea has never decreased below 6 billion USD that was recorded in 2013. After the FTA, South Korea's import share in Turkey's total imports has increased around 41% from 2,4% to 3,4%. In conclusion, Turkey's imports from South Korea has been always higher than Turkey's exports to South Korea. However, after signing Turkey-South Korea FTA, there has been an increase around 100% observed in Turkey's exports in South Korea. In conclusion, if Turkey-South Korea FTA has not been signed, it would create bigger trade deficits and uncompetitive trade for Turkey because the EU-South

⁶³ Source: Turkish Statistical Institute (Annual imports by country): http://www.tuik.gov.tr/PreIstatistikTablo.do?istab_id=625

Korea FTA would enable South Korea to export tariff-free while Turkey would still face tariffs while exporting to South Korea.

2.2. Chile Case

Association Agreement between Chile and the EU provides a comprehensive FTA that removes tariffs and trade barriers and enables protection for European intellectual property in Chile. After it came into force in 2005, customs duties on industrial product imports to the EU were completely eliminated in three years while customs duties on the industrial product to Chile were completely eliminated in seven years. Table 8 shows the trade balance and trade volume of Turkey with Chile in the period before and after the Mexico-EU trade agreement, which came into force in 2005, in thousand USD.

Table 8: Trade Balance and Trade Volume of Turkey with Chile (2000-2011)⁶⁴

Years	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Exports	16	19	19	15	24	24	34	41	150	37	81	130
Imports	92	73	79	160	176	326	441	533	324	200	311	474
Trade Balance	-76	-54	-59	-145	-152	-301	-407	-492	-174	-163	-230	-344

⁶⁴ Source: Turkish Statistical Institute (Annual trade balance and volume by country): http://www.tuik.gov.tr/PreIstatistikTablo.do?istab_id=625

Trade	108	93	99	176	201	351	477	576	474	238	393	605
Volume												

It can be seen from the table that especially after two years from 2005, the trade deficit has increased around 63%. The imports from Chile to Turkey in 2005 increased around 85% from 176 million USD to 326 million USD while the exports remained the same. The exports from Turkey to Chile ranked highest around 150 million USD in 2008. 105 million USD out of 150 million USD was the exports of iron and steel products that resulted in a lower trade deficit for Turkey. Additionally, trade volume between the two countries in 2008 and 2009 has shown a decrease after a continuous increase in previous years due to the global crisis.

Turkey has signed an FTA with Chile in 2009 and it came into force in 2011. The Chile-Turkey FTA includes “removal of tariffs and non-tariff barriers in trade between Chile and Turkey; structural adjustment; animal and plant health; intellectual, industrial and commercial property rights; rules and certificate of origin; national taxation; anti-dumping and lastly safeguard measures and balance of payments.” Chile and Turkey also agreed to expand the scope of the FTA to cover trade in services in 2013. Table 9 shows the export and import values as well as trade balance and trade volume in thousand USD after the Chile-Turkey FTA came into force.

Table 9: Trade Balance and Trade Volume of Turkey with Chile (2011-2018)⁶⁵

Years	2011	2012	2013	2014	2015	2016	2017	2018
Exports	130	174	219	198	187	217	255	386
Imports	474	466	405	363	282	233	265	370
Trade Balance	-344	-291	-187	-165	-95	-16	-10	16
Trade Volume	605	641	625	562	470	450	520	757

It can be clearly seen from the table that the trade deficit has continuously decreased and eventually Turkey showed a trade surplus in 2018. In conclusion, the EU-Chile FTA has enabled Chile to import tariff-free products and this created a big trade deficit for Turkey because Turkey was not able to have reciprocal access to Chile. However, after Turkey-Chile FTA, the trade deficit of Turkey has decreased and became a trade surplus in 2018.

3. Comparison of the EU Customs Unions (San Marino and Andorra)

The EU has two different Customs Union that is has been signed with two different countries: Andorra and San Marino. Andorra is a small country that is located in the middle of France and Spain. It is the 6th smallest country in the European continent

⁶⁵ Source: Turkish Statistical Institute (Annual trade balance and volume by country): http://www.tuik.gov.tr/PreIstatistikTablo.do?istab_id=625

and 16th smallest in the world with a population of around eighty thousand. Tourism and retail trade are the main sources of the economy in Andorra. According to the World Bank data, the GDP in Andorra decreased to \$3.013 billion after 2007. Andorra is considered as a rich country with per capita income that is above the EU standards.

According to Central Intelligence Agency, “Andorra has opened to foreign investment and engaged in other reforms, such as advancing tax initiatives aimed at supporting a broader infrastructure. Although not a member of the EU, Andorra enjoys a special relationship with the bloc that is governed by various customs and cooperation agreements and uses the euro as its national currency.”

The exports of Andorra are higher than its imports, which is why the country is experiencing a great trade deficit. As it can be seen from the Table 10, regionally Europe is the main trade area for Andorra with almost 91% of total import and 83,5% of total export volume. The EU is Andorra’s main trade partner while Spain accounts more than half of the trade in the country. Apart from European region, America and Asia slightly effect the overall trade in Andorra.

Table 10: Andorran Foreign Trade by Geographical Areas (2017)⁶⁶

	Imports		Exports	
	<i>M euros</i>	<i>% total</i>	<i>M euros</i>	<i>% total</i>
Europe	1,189.10	90.9	88.6	83.4
America	21.2	1.6	2.7	2.6
Asia	83	6.3	7.1	6.7

The economic relationship between Andorra and the EU started with the CU agreement. The CU between the Principality of Andorra and the EU (European Economic Community during that time) has been established for the industrial products in 1990. The CU Agreement eliminates the customs duties, charges having equivalent effect and quantitative restrictions in trade between the EU, Andorra and third countries in the customs union. The agricultural products are not covered in the CU between Andorra and the EU, however, the agreement has established a specific regime for the agricultural products.

Following the CU Agreement, Cooperation agreement has been signed in 2004. The main objective of this agreement is to provide cooperation on the broadest possible and mutual advantage in matters of common interest, such as the communication, information and culture, the environment, trans-European networks and transport, regional policy and etc. In the same year, Taxation of Savings agreement has been signed between both parties. “The agreement provides for a staged increase in the withholding

⁶⁶ Source: The Chamber of Commerce, Industry and Services of Andorra

tax from 15 to 20 and 35% over a number of years, with three-quarters of the tax revenues to be returned to the country of residence of the saver.”⁶⁷ Monetary Agreement has been signed in 2011, allowing Andorra to use euro as legal currency and mint euro coins up to a specified maximum value.

The CU between Andorra and the EU is generally seemed to be functioning well even if problems occur sometimes. The European Commission and the Joint Committee of Andorra meet once a year to find a solution to these problems. The full membership of the EU seems unlikely for the foreseeable future. The government of Andorra and several ministers have stated that there is no need to join the EU. However, it is obvious that Andorra should keep the relations with the EU active to be included in the European market and enhance the economy by exporting its products and providing services for the EU.

San Marino, a country located in the lands of Italy, is the 5th smallest country in the world and smallest independent state in Europe after Vatican City and Monaco. San Marino is considered as one of the wealthiest countries in the world because of the rate of GDP per capita around fifty-nine thousand dollars. The economy in San Marino depends mainly on tourism, electronics, manufacture, and banking. The manufacture and banking sectors account for more than half of the country’s GDP. As expected, Italy is the main trade partner of San Marino with around 80% of total exports.

⁶⁷ See Emerson, M. (2007). *“Andorra and the European Union”*

The diplomatic relationship between San Marino and the EU started in 1983 with the cooperation and talks about security, human rights policies. The current legal framework between the EU and San Marino consists of three agreements: The Cooperation and CU Agreement, Monetary Agreement and lastly Agreement on taxations of savings income. The Cooperation and CU Agreement has been signed in 1991 with the aim of strengthening the economic and social relations and promoting comprehensive cooperation between two parties. The Monetary Agreement has been signed in 2000, allowing San Marino to use the euro as its official currency. Agreement of taxation of savings income in the form of interest payment has been signed in 2004 to secure the adaptation by San Marino of equivalent measures to those applied by the EU. The current government of San Marino is taking actions for a better and closer relationship with the EU. There have been several diplomatic and political meetings regarding the future membership and greater integration of San Marino to the EU.

In order to understand the differences in the Customs Unions of Andorra, San Marino, and Turkey, it is better to understand the main differences of the countries first. Three countries differ in many aspects including their participation in world trade and the size of their economies. The biggest foundational difference between Andorra, San Marino, and Turkey is the market size. There is a big gap in the size of the countries and population. Andorra's population has been rising and decreasing mainly due to the migration. As it can be seen in Table 11, San Marino has the lowest population with

around 33,400 in 2017 compared to Andorra and Turkey. Andorran population has been recorded as 76,965 with more than twice of the size of the population in San Marino.

Table 11: Population of San Marino, Andorra and Turkey (2012-2017)⁶⁸

Series	Country	2012	2013	2014	2015	2016	2017
Population, total	Name						
Population, total	San Marino	31,914	32,303	32,657	32,960	33,203	33,400
Population, total	Andorra	82,431	80,788	79,223	78,014	77,281	76,965
Population, total	Turkey	74,569,867	75,787,333	77,030,628	78,271,472	79,512,426	80,745,020

Turkish population, on the other hand, has been increasing progressively in the past years due to the high fertility and migration rate. As it can be seen in the Table 11, Turkish population has ranked almost 81 million. Even Bayburt, the least populous city in Turkey, has more number of citizens with approximately 80,500 compared to the whole population of Andorra. Even by looking only to the population of two countries, it can be easily estimated that the functional progress of the CU of two countries work different because of the market size. The export volume of Andorra and Turkey is also really different as expected. The export volume index in Andorra has ranked 213 while it ranked 388 in Turkey in 2017.

⁶⁸ Source: World Bank data

While Andorra is free of the customs duties, only the agricultural products are subject to import duties if they're not certified as Andorran origin. On the other hand, the Agreement with San Marino and the EU covers all products of HS Chapters 1 to 97 except for the coal and steel products covered by the ECSC Treaty. However, unlike Turkey, Andorra and San Marino did not conclude any FTAs with any countries. Since the main trade partner of Andorra is located in the EU, such as Spain, France and Germany, and Italy for San Marino's case, both countries seem to not in need of FTAs with third countries.

The official agreement of the CU that was established between the EU and Turkey is substantially short compared to the regulation of the CU between the EU and Turkey. The CU of Andorra and San Marino does not mention anything about the FTAs unlike the CU between Turkey and the EU. However, it mentions the common provisions and arrangements for products that are not covered by the CU similar to the EU-Turkey CU. When the EU concludes FTAs with third countries, there is a joint declaration at the end of the Origin Protocol providing that products originating in the Republic of San Marino and/or Principality of Andorra shall be accepted by the third country concerned as originating in the Community/EU within the meaning of the Agreement. Andorra and San Marino have been successfully negotiated in all recent FTAs concluded by the EU.

CHAPTER VI: Solving the FTA Problem and Role of the EU

1. Actions and Possible Attempts to Solve FTA Asymmetry Problem

Modernization of the EU-Turkey CU has been argued in many studies, including the Turkish government, the European Commission and World Bank studies. Most of these arguments support that the FTA asymmetrical problem can be avoided by modernizing the current CU. Ülgen, S. and Y. Zahariadis (2004) argues that “feasible solutions can be found to FTA problems, which prevent unnecessary friction between the customs union partners or a perceived trade diversion and export impediment for the Turkish side.” Again, they emphasize that a feasible solution should be found for both parties and they suggest that “with respect to adopting FTAs by Turkey, the EU must undertake a significant effort to alleviate the concerns of the Turkish side in terms of the policy dependency framework, particularly in relation to the development of a genuinely common commercial policy. Yet both the EU and Turkey must start to address this issue in more imaginative ways so as to bring workable, adaptable and flexible solutions to the core problems of policy dependency and institutional cooperation.”⁶⁹

⁶⁹ See Ülgen, S. and Y. Zahariadis (2004). *“The future of Turkish-EU trade relations: Deepening vs widening”*

“If an efficient mechanism is not set up to ensure proper cooperation and consultation between the parties, the new initiative of EU to FTAs will further complicate the present problems and undermine the proper functioning of CU. Obviously, there are some negative political and economic ramifications of this situation on the overall relations between EU and Turkey.”⁷⁰

In the World Bank (2014a) document, it is emphasized that “while the first best solution would be to move forward with accession negotiations, other actions could be taken in the meantime to reduce the impacts of asymmetries, such as establishing ‘Friends of Turkey’ working groups, and increasing Turkish representation on comitology committees.”⁷¹ Yalcin, E., et al. (2016) point out on their study that “Turkey is in a poor position to negotiate its own free trade agreements with the EU’s new free-trade partners in order to overcome the threat of imbalance. Various political alignment options are currently being discussed in Turkey, although it is questionable whether some of the proposals can be accomplished in a timely manner.”⁷² According to their study four scenarios are possible over the coming years: EU membership for Turkey, (ii) Adoption of EU mandate for Turkey, (iii) Rollback of the customs union to a free trade agreement, A more comprehensive customs union. However, the EU membership of Turkey seems

⁷⁰ See Çalışkan, Ö. (2009). *"An analysis on the alignment process of Turkey to the EU's FTAs under the customs union and current challenges."*

⁷¹ See the report World Bank (2014a). *Evaluation of the EU - TURKEY Customs Union (85830-TR)*

⁷² See Yalcin, E., et al. (2016). *"Turkey's EU integration at a crossroads."*

very unlikely due to the negative political dialogs and current situation of Turkey. The other scenarios might work out better than current CU but they all require a certain commitment from the EU.

As mentioned before, the EU is currently in negotiations for deeper trade agreements with the impasse in the Doha Round for multilateral trade negotiations. The cost of the FTA asymmetries will increase with deeper trade agreements with big markets. When the EU concludes an FTA with a third party, it considers not only the members of the EU but also Turkey since it is a customs area. This is why upgrading and modernizing the CU will be more important for Turkey. Both the Turkish government and the EU recognize the shortcomings of the CU, including the FTA asymmetry problem and agreed on modernizing and updating the CU. In 2015, the European Commission and the Turkish government have officially started the negotiations on CU modernization. However, it is unclear to what extent it will be accomplished.

The EU must consider negotiations about the FTA problem and provide a better solution that works for both parties. As Erzan, R. (2018) highlights, “from the EU’s point of view, the commercial ties with Turkey are not easily dispensable either. Turkey is EU’s 4th largest export market and 5th largest provider of imports. With a back of the envelope calculation based on the Commission’s estimates for overall job creation of EU’s external trade, exports to Turkey could be worth about 1.5 million jobs. Furthermore, on average, every €1 billion additional exports would be generating about 14,000 jobs in the EU. The

European Parliament (EP) has adopted a new resolution on the EU-Turkey relations in 2016.”⁷³ Therefore, the modernization of the CU has a big importance in the bilateral trade between two parties and accession process of Turkey to the EU.

Akman, M. S. (2010) underlines that “the operation of the Customs Union became a target for criticism mainly because of the impasse at Turkey-EU relations. Therefore, further steps to consider Turkish interests in the formulation of EU FTAs with third countries can alleviate such justifiable criticism in Turkey. At this point, two different but related avenues of action seem contributive. First, the institutional mechanism should be restructured to take into consideration of Turkey’s interests accordingly in order to diminish unfavorable effect of change in EU trade policy. Second, extension of the customs union into areas such as agriculture and trade in services shall help Turkey to gain additional trade benefits that Turkish exporters can enjoy.”⁷⁴

⁷³ See Erzan, R. (2018). *"Customs Union between EU and Turkey: A Success Story to be Nurtured."*

⁷⁴ See Akman, M. S. (2010). *"The European Union's trade strategy and its reflections on Turkey: An evaluation from the perspective of free trade agreements."*

2. What have been done so far?

2.1. Joint Declaration (Turkey Clause)

In order to prevent trade deflection in Turkish side, the EU started to introduce a ‘Turkey Clause’ in its new trade agreements. Turkey Clause asks its trading partner to negotiate and conclude a similar agreement with Turkey. As Ülgen, S. and Y. Zahariadis (2004) point out, “a suggestion to conclude similar bilateral trade agreement may be to invoke a new sort of conditionality, whereby the ratification of the free trade agreement between the EU and a third country could be made conditional to the conclusion of a free trade agreement with Turkey.”⁷⁵ The joint declaration is usually for the countries that have CU with the EU, including San Marino and Andorra besides Turkey. However, the objective of joint declaration is to initiate third countries to engage in FTAs with Turkey since San Marino and Andorra does not have any FTA agreements. Table 12 and 13 show the Joint Declaration example of the EU. Table 12 shows the Annex 30-D of The Comprehensive and Economic Trade Agreement between the EU and Canada.

⁷⁵ See Ülgen, S. and Y. Zahariadis (2004). “*The future of Turkish-EU trade relations: Deepening vs widening*”

Table 12: Joint Declaration of Canada-EU trade agreement⁷⁶

**“JOINT DECLARATION OF THE PARTIES ON COUNTRIES THAT HAVE
ESTABLISHED A CUSTOMS UNION WITH THE EUROPEAN UNION**

1. The European Union recalls the obligations of the countries that have established a customs union with the European Union to align their trade regime to that of the European Union, and for certain of them, to conclude preferential agreements with countries that have preferential agreements with the European Union.

*2. In this context, **Canada shall endeavour to start negotiations with the countries which,***

have established a customs union with the European Union, and whose goods do not benefit from the tariff concessions under this Agreement,
with a view to conclude a comprehensive bilateral agreement establishing a free trade area in accordance with the relevant WTO Agreement provisions on goods and services, provided that those countries agree to negotiate an ambitious and comprehensive agreement comparable to this Agreement in scope and ambition. Canada shall endeavour to start negotiations as soon as possible with a view to have such an agreement enter into force as soon as possible after the entry into force of this Agreement.”

⁷⁶ Source: EUR-Lex website: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016PC0470> (COUNCIL DECISION on the provisional application of the Comprehensive Economic and Trade Agreement between Canada of the one part, and the European Union and its Member States)

In the first part, it is clearly mentioned that Turkey has to align its trade regime to that of the EU and adopt the common commercial policy towards Canada. Also, it was mentioned that Turkey should start negotiations and/or conclude an FTA with Canada. Second part invites Canada to start FTA negotiations with Turkey as soon as possible. Accordingly, Turkey indicated its interest in pursuing an FTA with Canada in 2009. However, there is no concrete result shows that Canada is also willing to start FTA negotiations with Turkey.

Table 13 shows the example of a joint declaration in the Japan-EU Economic Partnership Agreement. Similar to the joint declaration in CETA, it is mentioned that Turkey has to align its trade regime to that of the EU and adopt the common commercial policy towards Japan. However, unlike Canada, Japan has already started negotiations with Turkey at the time the EU-Japan Economic Partnership Agreement was entered into force in February 2019. Therefore, this joint declaration invites Japan to conclude negotiations and sign an FTA with Turkey as soon as possible. Consequently, negotiations between Japan and Turkey regarding an FTA has been going smoothly and it is estimated that the Japan-Turkey FTA will be signed in June prior to the G20 summit.

Table 13: Joint Declaration of Japan-EU trade agreement⁷⁷

“JOINT DECLARATION

The European Union recalls the obligations of third countries that have established a customs union with the European Union to align their trade regimes to that of the European Union and, for some of them, to conclude preferential agreements with countries that have entered into preferential agreements with the European Union.

*In this context, the Parties note that **Japan has already started negotiations with one of those countries which have established a customs union with the European Union** and whose products do not benefit from the tariff concessions under this Agreement, with a view to concluding a bilateral agreement establishing a free trade area in accordance with Article XXIV of GATT 1994.*

The European Union invites Japan to conclude negotiations as soon as possible with a view to having the above mentioned preferential agreements enter into force as soon as possible after the entry into force of this Agreement.”

Even though the Commission has been advising countries to negotiate an FTA with Turkey, they have been unsuccessful so far. Turkey Clause was first used in the EU’s negotiations with Algeria in 2005, but it failed to persuade Algeria to negotiate FTA with Turkey. The EU simply cannot force third countries to conclude negotiations with Turkey because Turkish Clause is not a part of the EU’s negotiation mandate. As it can be seen

⁷⁷ Source: EUR-Lex website: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0192> (COUNCIL DECISION on the conclusion of the Economic Partnership Agreement between the European Union and Japan)

from the example of South Africa-EU FTA case, Turkey Clause is sometimes dropped from the negotiations. However, as Akman, M. S. (2010) implies, “this can only have an economic meaning in the case of countries whose market is constantly or potentially significant for Turkish interests. Paradoxically these are the countries in which the EU will be least responsive because the addition of Turkish stake into EU’s interests function may not yield a gain for the EU itself.”⁷⁸ The South Korea-EU FTA shows that Turkey Clause has provided impetus to the process as within six months and consequently South Korea has agreed to negotiate an FTA with Turkey.

Additionally, as it was mentioned in the Comparison of EU Customs Unions part, the EU concludes a joint declaration at the end of the Origin Protocol providing that products originating in the Republic of San Marino and/or Principality of Andorra shall be accepted by the third country concerned as originating in the Community/EU within the meaning of the Agreement. The recognition of Andorra and San Marino have been successfully negotiated in all recent FTAs concluded by the EU, however, this declaration does not always work for Turkey. The Government of Turkey has provided the European Commission a mandate to negotiate a strengthened Turkey Clause with the aim of a way to ensure the parallel track for the future EU FTAs. Revised Turkey Clause is as follows:

⁷⁸ See Akman, M. S. (2010). *"The European Union's trade strategy and its reflections on Turkey: An evaluation from the perspective of free trade agreements."*

Table 14: Example of revised Turkey Clause by Turkish Government⁷⁹

“Example of revised Turkey Clause (Joint Declaration Concerning Turkey)”

The EU recalls the Customs Union between the EU and Turkey based on the principle of free movement of goods, whereas goods originating in third countries can freely circulate between Turkey and the EU once all import formalities are completed in Turkey or in the EU, and the requirement of the parties within the Customs Union to apply common commercial policies including preferential trade agreements and the common customs tariff in accordance with Article XXIV of the GATT.

In this context, the EU and [FTA partner] have declared as follows:

- 1. [FTA partner] and Turkey shall conclude an FTA between the two parties on a mutually advantageous basis, to enter into force simultaneously with the entry into force of the agreement between the EU and [FTA partner].***
 - 2. If the agreement between the EU and [FTA partner] enters into force before the agreement between [FTA partner] and Turkey, products originating in Turkey falling within Chapters 25 to 97 of the Harmonized System and which are in free circulation in the EU shall be accepted by [FTA partner] as originating in the EU within the meaning of this Agreement, until the entry into force of the FTA between [FTA partner] and Turkey.***
 - 3. The rules established to define the originating status of the products subject to this Agreement shall apply mutandis for the purpose of defining the originating status of the products mentioned in paragraph 2.”***
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⁷⁹ Ministry of Economy, Government of Turkey.

It is specifically mentioned in the revised declaration that third countries that conclude an FTA with the EU shall also conclude a separate FTA with Turkey that enters into force simultaneously. Turkey tries to avoid trade deficits that are caused by the new trade partners of the EU since they can enter the Turkish market tariff-free while Turkey is still exposed to tariffs while exporting to those countries. Another emphasis Turkish government makes is that if it takes longer for Turkey to conclude an FTA with the third party after the EU, the third party shall treat products originating in Turkey exactly same with those of the EU. In other words, third parties shall use the same tariff schedule towards Turkey exactly the same with the EU. Along the same line, Turkey tries to prevent possible trade deficit that is caused due to the asymmetrical tariff schedule.

3. What can be done in the future?

3.1. Joint Negotiations

In order to avoid the asymmetries in the FTA process, one of the best solutions would be to have a single and joint negotiation because FTA problems mainly arise from the fact that Turkey does not have right to participate the EU's decision-making process. In other words, Turkey cannot take part in the formation of the EU's common commercial policy towards third parties. "An effective procedure could be implemented to allow Turkey to have observer status in the Council meetings discussing trade negotiations, or in Committee 133, where the EU's common negotiation position is determined, particularly when decisions are made in areas directly related to the customs union with

Turkey.”⁸⁰ “This would enable future FTAs to be negotiated and concluded to include truly common arrangements and measures to ensure the integrity of the common commercial policy and prevent any possibility of trade deflection.”⁸¹

World Bank (2014a) report suggests that “there would be greater institutional commonality in terms of decision making regarding the common commercial policy as it relates to the under the joint negotiation.”⁸² When the EU negotiates an FTA, Turkey could participate in the Trade Policy Committee and have a vote. This would ensure the integrity and eliminate any possible trade deflection. Even though joint negotiation seems like a good idea to solve this problem, the EU do not allow a joint negotiation with a non-EU country because of the institutional realities. The trade negotiations are carried out by the Commission that gives mandate to set up a Council Working Group from twenty eight member states. The Commission cannot engage in negotiations on behalf of a non-EU country.

3.2. Enhanced Commercial Framework

In 2016, the European Commission has announced two different studies regarding the modernization of the CU. One of them was the Impact Assessment that

⁸⁰ See Özer, Y. (2019). *“External differentiated integration between Turkey and the European Union: the customs union and its revision.”*

⁸¹ See Nas, Ç. and Y. Özer (2017). *“Turkey and EU Integration: Achievements and Obstacles”*

⁸² See World Bank. (2014a). *“Evaluation of the EU - TURKEY Customs Union (85830-TR)”*

authorizes to open negotiations with Turkey for extending the scope of the bilateral preferential trade relationship. The other one was the final report on the EU-Turkey BPTF and its possible enhancement. In the second report, one of the solutions to modernize CU was the Enhanced Commercial Framework (ECF). ECF is described as the CU with no scope change except the industrial products. The Coal and Steel Agreement (CSA) and an FTA cover trade in agriculture and fishery products, services and establishment, non-tariff barriers and public procurement. In other words, ECF represents a continued and scope unchanged CU (only institutionally enhanced) with CSA and FTA covering trade in agriculture and fishery products, non-tariff barriers, services and establishment as well as public procurement. This option requires strong political dialogues from both the EU and Turkey because of strong commitments that come with enhancement.

As Erzan, R. (2018) points out, “this benign scenario generates a GDP increase of about 1.5% for Turkey. This figure goes up to 2% or higher if Turkey manages to secure FTAs with its other major trade partners. The GDP impact on EU in percentage terms appears small due to EU’s sheer size. However, in absolute terms, this effect is substantial, about half of the amount that incurs to Turkey. In their bilateral trade, both Turkey and particularly the EU make important gains in exports. Turkey also substantially expands exports to third parties.”⁸³ According to the study of European Commission. (2016b), “the ECF generates economic gains for both Turkey and the EU. Turkey’s

⁸³ See Erzan, R. (2018). *"Customs Union between EU and Turkey: A Success Story to be Nurtured."*

imports from less developed countries decrease by EUR 1.3 billion while the EU's imports from less developed countries increase by EUR 0.7 billion. In other words, there is some erosion of net exports for third countries even though the overall impact is not severe. Also, real imports and exports of goods and services for both countries increase faster than real GDP. With the EFC option, Turkey will be expected to keep its alignment for laws and regulations with those of the EU considering the size difference of both parties. A new mechanism that provides stronger coordination between the EU and Turkey could be established with the EFC option. This mechanism would help Turkey to take necessary measures with FTA partners of the EU. Another mechanism could be provided to share information on the ongoing FTA negotiations with third parties. In order to eliminate the asymmetries, different ways for implementing the reciprocity for Turkish access to the EU's new FTAs could be established with EFC option.”⁸⁴ Yalcin, E. (2016) suggests a more comprehensive customs union to overcome the negative welfare effects of the asymmetrical system. He implies that “the European customs agreement could be expanded with a passage in which all of the EU's trade agreements with third countries are automatically extended to customs-union members too.”⁸⁵

In the Impact Assessment paper of the European Commission (2016a), the EFC option is described as the CU modernization and FTA in additional areas (CU+FTA).

⁸⁴ See the report European Commission. (2016b). *“Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement.”*

⁸⁵ See Yalcin, E. (2016). *“EU-Turkish Customs Union: A Reasonable Roadmap”*

Similar to the EFC, CU+FTA emphasizes the modernization of the CU by improving its functioning, addressing its design deficiencies and extending the scope of the bilateral trade with a new FTA that covers liberalization in services and agriculture, establishment and public procurement.

Impact Assessment paper also emphasizes Turkey's difficulty in concluding FTAs with third countries and shows that Turkey can also benefit from the trade preferences of the EU FTAs. With CU+FTA option, both sides would explore improvements in the exchange of information mechanism to facilitate Turkey's alignment with the EU. Regarding the dispute settlement mechanism, CU+FTA option takes into consideration of including an arbitration panel with binding rulings and mediation mechanism to find solutions to problems. Considering the structure and trade costs, some of the researches think that modernization and upgrading the CU seems to be more beneficial than eliminating CU and replacing it with a deep and comprehensive FTA.⁸⁶

3.3. Deep and Comprehensive Free Trade Area

Deep and Comprehensive Free Trade Area (DCFTA) was suggested as another option in the European Commission studies. This option replaces the CU with an FTA that covers all goods trade including industrial, agricultural and fishery products, services,

⁸⁶ See the report European Commission. (2016a). *"Impact Assessment."*

non-tariff barriers, public procurement as well as the establishment. Considering that the EU's current aim towards free trade agreements became more like deep and enhanced while the current CU between Turkey and the EU becomes outdated, Turkey would be more eager to establish a deep and comprehensive agreement with the EU. Also, Colares, J. F. and M. T. Durmus (2019) emphasize that "since Turkey's main trade objective has been to reduce its uninterrupted trade deficit, a CU-free Turkey could improve market access for its exports by offering new concessions based on the significant reserve of tariff discretion available in its WTO tariff bindings."⁸⁷ There might be more benefits if FTA is concluded between the EU and Turkey rather than CU. It would have been better for Turkey to have signed an FTA with the EU if we consider the especially after the EU's 2006 change of trade strategy in favor of FTAs. This would have given Turkey more flexibility in chasing a more efficient trade policy with third countries. Therefore DCFTA option would also solve the asymmetry problem because FTA replaces the CU in industrial goods, costs arising from rules of origin are reestablished and Turkey can apply its full tariffs to third parties that have FTAs with the EU, but not with Turkey.

"The scope of the DCFTA is the same to the EFC, however it is less ambitious in terms of depth of liberalization in the goods and services. Compared to the EFC, the bilateral trade gains with Deep and Comprehensive Free Trade Area (DCFTA) are more modest" according to the European Commission (2016b). The net gains for the EU is

⁸⁷ See Colares, J. F. and M. T. Durmus (2019). "*TURK-SWITCH: The Tariff-Leverage and Legal Case for Turkey's Switch from EU-Turkey Customs Union to FTAs with the European Union and Beyond.*"

EUR 8 billion while Turkey faces a decline for bilateral exports to the EU of EUR 5.3 billion.⁸⁸

As Ülgen, S. and Y. Zahariadis (2004) underlines, “the EU must undertake a significant effort to alleviate the concerns of the Turkish side in terms of the policy dependency framework, particularly in relation to the development of a genuinely common commercial policy. Yet both the EU and Turkey must start to address this issue in more imaginative ways so as to bring workable, adaptable and flexible solutions to the core problems of policy dependency and institutional cooperation.” “There are, however, no simple solutions to this dilemma. Turkey cannot automatically be made a party to the free trade agreements that the Community has negotiated or will negotiate. There will have to be separate negotiations. Yet the Community can induce a trading partner to open and conduct these negotiations in good faith with Turkey as well.”⁸⁹

⁸⁸ See the report European Commission. (2016b). *“Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement.”*

⁸⁹ See Ülgen, S. and Y. Zahariadis (2004). *“The future of Turkish-EU trade relations: Deepening vs widening”*

CHAPTER VII: Conclusion

Customs Union has been established through the EU-Turkey Association Council Decision 1/95 in 1996 as a final step of the Association Agreement that was signed in 1963. The EU-Turkey CU that covers industrial goods including processed agricultural commodities but excluding ECSC products has contributed economic benefits for both sides substantially. Turkey was the ‘5th largest partner for exports of goods from the EU’ and ‘6th largest partner for imports of goods to the EU among the EU’s trading partners’ in 2017. Turkey’s competitiveness in manufacturing sectors, demand for Turkish exports in the EU market and the foreign direct investment flow to Turkey has increased significantly during the EU-Turkey CU period.

Due to CU obligations, Turkey adopted the common commercial policy of the EU and started to use common external tariff towards imports from third countries. CU enables the third parties, which have an FTA with EU, tariff-free access to Turkey. Consequently, even if the subject third country does not have FTA with Turkey, they still enjoy the benefits of the Turkish market as long as they have FTA with the EU. Turkey does not have the authority to grant tariff preferences impartially of the EU, nor can it adopt lower tariffs than the common commercial tariff in its bilateral trade agreements. In this case, Turkey has no other option but to sign an FTA with that third party in order to prevent possible trade deficit.

As another obligation of the EU-Turkey CU, Turkey has agreed to engage in FTA negotiations in parallel with the EU. After the establishment of CU, there have been a great number of FTAs concluded by the EU. Currently, Turkey has 19 FTAs in force and most of them faced asymmetrical legal bindings when they entered into force. “Accordingly, Turkey’s FTAs usually enforces Turkey to abolish tariffs and similar measures as soon as the agreement enters into force, while allowing the partner country to dismantle its barriers to Turkish products progressively.”⁹⁰ For instance, countries like Morocco, Egypt and Tunisia had to follow different time schedule while abolishing customs duties for industrial products originating from Turkey. Time gap vary from 9 years to 13 years depending on the schedule from the EU Association Agreements or Turkey FTAs.

The effect of the EU’s FTAs on Turkey is most of the times negative due to the fact that the EU’s FTAs create trade deficit in Turkey until Turkey signs a separate trade agreement with that country. However, some of the countries with which the EU had concluded or continue to negotiate FTAs are not eager to have a parallel preferential agreement with Turkey because they already gain preferential access to Turkish market thanks to the EU-Turkey CU. Additionally, after Turkey tries to start negotiations for an FTA with the third party that has concluded an FTA with the EU, this time period puts Turkey out of countenance and creates asymmetrical market competition. For instance,

⁹⁰ See Akman, M. S. (2010). *"The European Union's trade strategy and its reflections on Turkey: An evaluation from the perspective of free trade agreements."*

countries like Mexico, South Africa, and Algeria benefit tariff-free Turkish market while Turkey has to face tariffs from these countries because there is no FTA between them. Turkey has been continuously facing a trade deficit from Mexico except 2001, 2002 and 2004. Similar to Mexico, Turkey has been facing continuous trade deficit that ranked up to 1,5 billion USD from South Africa. On the other hand, South Korea and Chile cases show that FTAs signed with third countries after the EU can still prevent or decrease the trade deficit in Turkey. After South Korea-Turkey FTA that came into force in 2013, Turkey's exports to South Korea have increased by approximately 98% from 460 million USD to 929 million USD. Additionally, Chile case shows that after Chile-Turkey FTA that came into force in 2011, the trade deficit of Turkey continuously decreased and finally Turkey made a trade surplus in 2018.

When the EU-Turkey CU was established, Turkey was expected to be a full member of the EU in four to eight years if the membership obligations were fulfilled. Therefore, Turkey did not consider the decision-making process as a big problem because it was supposed to be temporary. Nevertheless, after more than twenty years from the establishment of CU, Turkey is still not a member country of the EU and the lack of voice in decision making creates a problem for Turkey. The asymmetrical FTAs became a frustration for Turkey especially after the mid-2000s because of the EU's new trade strategy of comprehensive FTAs and lack of voice in the negotiations of these agreements.

Andorra and San Marino, which also have a separate CU with the EU, have been successfully negotiated in all recent FTAs concluded by the EU unlike Turkey. The EU started to add a 'Turkey Clause' that asks its trading partner to negotiate a similar agreement with Turkey but this declaration is not legally binding so most of the times countries do not favor starting negotiations for a separate FTA with Turkey. Turkish Government has announced a revised Turkey Clause that emphasizes third parties shall conclude another FTA with Turkey in parallel with the EU, and if there is a delay until third parties conclude an FTA with Turkey after the EU, third parties shall obtain the same custom tariffs with the EU for Turkish products. Joint Declaration has not been successful so far except some cases like South Korea or Chile.

There have been a number of possible options suggested by researchers to solve the asymmetrical FTA problem. One of the possible options is to start single and joint negotiations where Turkey participates as an observer and have the right to discuss its economic benefits or losses from these agreements. Another option would be an enhanced commercial framework that keeps the same structure but adding an FTA that covers trade in agriculture and fishery products, services and establishment, non-tariff barriers and public procurement. With the enhanced commercial framework, both sides would have improvements in the exchange of information mechanism to enable Turkey's alignment with the EU. Regarding the dispute settlement mechanism, this option takes into consideration including an arbitration panel with binding rulings and mediation mechanism to find solutions to problems. Lastly, replacing CU with an FTA that covers

all goods trade including industrial, agricultural and fishery products, services, non-tariff barriers, public procurement as well as the establishment can be seen as another option. The scope of the DCFTA is the same as the EFC, however, it is less ambitious in terms of liberalization in the goods and services.

Asymmetrical FTAs could create bigger problems in the future since the EU is currently in negotiations for deeper trade agreements. Both the Turkish government and the EU recognize the shortcomings of the CU, including the FTA asymmetry problem and agreed on modernizing and updating the CU. In 2015, the European Commission and the Turkish government have officially started the negotiations on CU modernization. However, it is unclear to what extent it will be accomplished.

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Abstract in Korean (국문 초록)

유럽 연합 - 터키 관세 동맹 FTA 과정의 비대칭: 효과와 향후 방향

터키와 유럽 연합 (EU) 간의 관세 동맹은 1996 년에 설립된 이래로 양국 경제에 많은 공헌을 해왔습니다. 그러나 현재의 관세 동맹은 미래의 경제적 이득을 저해할 수 있는 몇 가지 문제점들을 보이고 있습니다. 본 연구에서는 유럽연합 (EU)과 터키 간의 관세 동맹 문제 중 하나인 대외 무역 협정 (FTA) 과정의 비대칭에 초점을 맞출 것입니다.

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뿐만 아니라 터키는 제 3 국과의 협상을 시작하거나 새로운 무역 협정을 체결할 때 EU 의 구속력을 받게 되어 있습니다. 특히, EU 의 새로운 무역 전략이 대국 경제와의 깊고 포괄적인 무역 협정을 가져오게 됨으로써 터키 미래 경제에 더 큰 문제를 야기할 수 있게 됩니다. 이 때문에 터키는 이 문제를 해결할 수 있는 가능한 방안을 모색하고 있습니다.

키워드 : 터키 - 유럽 연합 관세 동맹, FTA 비대칭, 공동 상업 정책, 무역 적자